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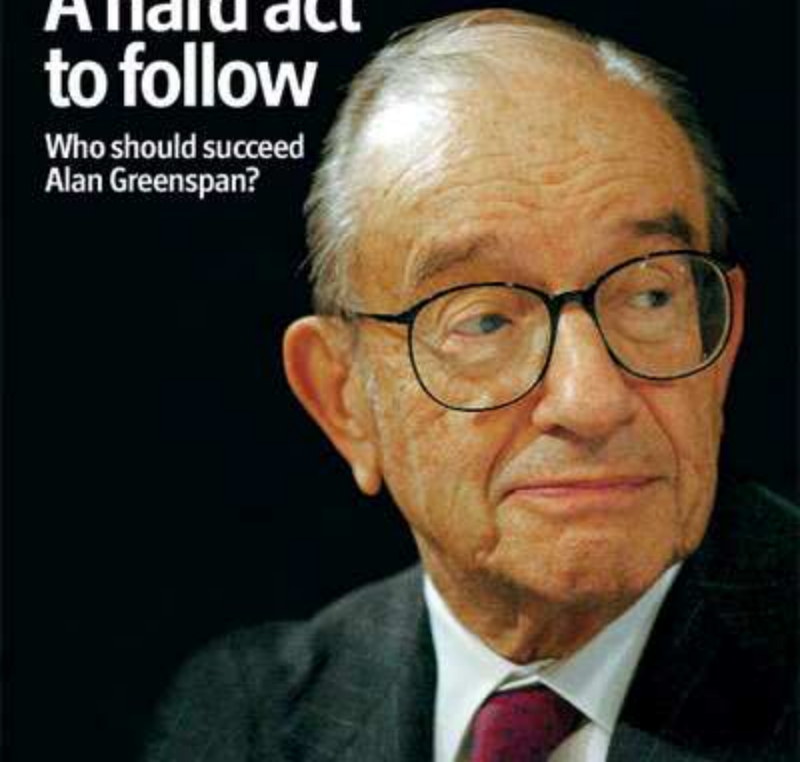

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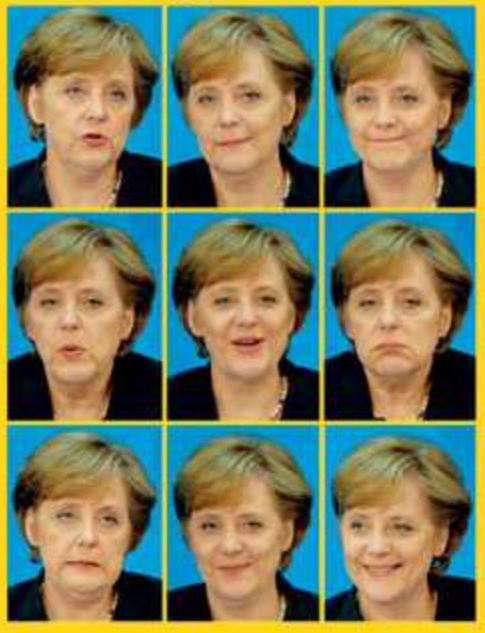

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Politics this week

Oct 13th 2005
From The Economist print edition

Devastation in Kashmir

Reuters

An **earthquake** of magnitude 7.6 devastated Kashmir. The worst damage was in the Pakistani-administered areas, where at least 30,000 people, and perhaps many more, were thought to have died. At least 1m people were left homeless. Relief efforts were slow to get under way, hampered by bad weather and military restrictions. See article

China launched its second manned space-rocket. The *Shenzhou 6*, carrying two astronauts, was successfully placed in Earth orbit. See article

North Korea held mass celebrations for the 60th anniversary of the founding of its ruling Workers' Party. An official took the opportunity to give warning that his country would "mercilessly crush" American and Japanese forces if they threatened it.

America and **Kirgizstan** reached an agreement to allow coalition forces in Afghanistan to continue using a military base near the Kirgiz capital, Bishkek. The issue gained prominence after Uzbekistan told America to leave its base there by the end of this year.

With friends like these

The White House found itself under mounting attack over its nomination of Harriet Miers to the **Supreme Court**. Some of George Bush's supporters said she was not conservative enough; others accused him of cronyism for picking his own lawyer for the job. See article

The United States Army Corps of Engineers finished pumping the remaining floodwaters out of **New Orleans**; all areas of the city are now accessible. Separately, an inquiry was launched into the apparent beating of a 64-year-old black man by two of the city's (white) police officers that was shown on television.

New York's mayor, Michael Bloomberg, insisted the city had done the right thing in increasing security measures on the subway system in response to what was thought to be an imminent terrorist attack. Briefings by federal officials cast doubt on the credibility of the information, apparently gleaned from an informer in Iraq.

Judith Miller, a journalist jailed for refusing to talk about her sources, testified for a second time to a grand jury investigating the leaking of Valerie Plame's identity as a CIA agent. **Karl Rove**, Mr Bush's main political adviser, agreed to testify for a fourth time.

She finally made it

Angela Merkel was on course to become the first female chancellor of **Germany** after striking a political deal that will give her Social Democrat rivals some of the most powerful ministries. In his farewell speech, the outgoing chancellor, Gerhard Schröder, said that he would not serve in a government led by his Christian Democratic opponent. See article

Gun-battles raged in the southern **Russian** town of Nalchik, near Chechnya, after fighters described as "religious extremists" attacked government buildings. Scores of casualties were reported. See article

AP

The European Commission said that tests in Turkey had proved positive for the most dangerous H5N1 strain of **bird flu** that is currently circulating in Asia. Earlier, the commission slapped a ban on all imports of live birds and untreated feathers from both Turkey and Romania, where bird flu was also detected.

The EU's commissioner for enlargement met Orhan Pamuk, a Turkish novelist, to discuss **Turkey's** record on free speech. Mr Pamuk faces trial for allegedly insulting Turkey about its relationship with Armenians and Kurds. Last week, Hrant Dink, a journalist of Armenian-Turkish descent, was given a six-month suspended sentence for insulting Turkish nationality.

Mr Pamuk had also been in the running for the **Nobel prize for literature**, which was won by Harold Pinter, a British playwright and critic of the war in Iraq.

Jean-Bernard Merimée, France's former ambassador to the UN and a special adviser to Kofi Annan between 1999 and 2002, was formally placed under investigation in France on suspicion of receiving illegal Iraqi oil allocations under the UN's **oil-for-food** programme.

The aftermath of Stan

Guatemala ended a search for survivors after a week of flooding and mudslides caused by torrential rains following Hurricane Stan. The death toll in the country stood at over 650, but was expected to rise as the recovery of bodies began in two villages near Lake Atitlan that were buried under mud. Over 130 people were killed in the rest of Central America. See article

Several governments placed restrictions on beef imports from **Brazil** after an outbreak of foot-and-mouth disease in the southern state of Mato Grosso do Sul.

The **Canadian Broadcasting Corporation** resumed normal programming after unions ratified a deal to end a two-month management lock-out. The start of the new National Hockey League season, a huge source of commercial revenue for the public broadcaster, persuaded bosses to back down from most of their plans relating to the hiring of temporary employees.

A Sunnier outlook

In the run-up to a referendum on October 15th on a draft constitution, **Iraq's** parliament, dominated by Shia Arabs and Kurds, made last-minute concessions to disaffected Sunni Arabs in the hope that they would not block the document's endorsement: if two-thirds of voters in three of Iraq's 18 provinces say no, it will fail. See article

Ghazi Kanaan, **Syria's** interior minister, who was his country's proconsul in Lebanon for 20 years

until 2002, died, officially by his own hand. This increased speculation that the UN's investigation into the murder earlier this year of Rafik Hariri, a long-time Lebanese prime minister, was closing in on Syria's top people, perhaps even threatening the president, Bashar Assad. See article

Liberians went peacefully to the polls in the first round of their first general election since the end of a civil war nearly three years ago. George Weah, a former footballer, was expected to vie with Ellen Johnson-Sirleaf, a former World Bank and UN official, for the lead.

AP

Provisional results of a general election in the breakaway state of **Somaliland,** still technically part of anarchic Somalia, suggested that the two main opposition parties had scored well against the president's ruling one.

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Business this week

Oct 13th 2005
From The Economist print edition

A worrying legacy

Delphi, America's largest supplier of auto parts, sought bankruptcy protection for its domestic operations. The firm is negotiating with unions to cut its “legacy costs” in pension and health-care provision. The move is a worrying portent for America's troubled carmakers. The share price of **General Motors** fell by 10% after the carmaker gave warning that Delphi's woes could cost it up to $11 billion in benefits it guaranteed to Delphi's workers when it spun off the firm in 1999. See article

Bridgestone Firestone ended a long-running dispute with **Ford** by agreeing to pay $240m to settle claims stemming from a huge safety recall of its tyres in 2000.

Inco, a Canadian mining company, said it was buying **Falconbridge**, a domestic rival, in a deal worth around C$12 billion ($10.2 billion) that creates the world's biggest producer of nickel. Xstrata, based in Switzerland, had expressed keen interest in Falconbridge, taking a 20% stake in August.

Carl Icahn sent an open letter to shareholders in **Time Warner** attacking the “dismal record” of management. The billionaire investor heads a consortium with a 2.8% stake in the media conglomerate that wants the group to spin off its cable-TV unit and buy back billions in shares. See article

Rupert Murdoch said that his decision in August to prolong a poison pill in **News Corporation** (designed primarily to stop John Malone's Liberty Media from increasing its voting stake in the group) was “totally legal”. Last week, a group of investment and pension funds filed a lawsuit in Delaware to block the extension, arguing shareholders should have been consulted first.

Seeking new alliances

It was a busy week for **Microsoft.** The software giant reached a $761m settlement with **RealNetworks**, ending the last major antitrust lawsuit brought against it in America. The two companies also agreed to collaborate to tackle growing competition from firms offering media downloads over the internet. Microsoft then announced an alliance with **Yahoo!** that enables interaction between their instant-messaging services, a direct challenge to AOL. Techies were also excited by reports that both Microsoft and **Google** (in alliance with **Comcast**, a cable-TV operator) were jostling to buy a stake in AOL. See article

Apple Computer reported net profit of $1.34 billion for the year ending September 24th, a 384% increase on a year earlier. However, although this was “the best year in the company's history”, Apple's share price fell on news that the 6.5m shipments of its iPod music player in the fourth quarter had fallen short of Wall Street's expectations. Apple also launched its new **video iPod**, and announced a deal with **Disney** enabling the download of some popular TV shows on to the

device.

India's two biggest providers of software services, **Infosys Technologies** and **Tata Consultancy Services**, reported a rise in net profit for the quarter ending September 30th of 36% and 20.5% respectively, compared with a year earlier. Both firms benefited from inclusion in a big contract to manage ABN Amro's IT systems.

Paying your debt

Refco, a large futures and commodities broker based in New York, replaced its boss, Phillip Bennett, for allegedly using a separate company to “hide” $430m. Mr Bennett (who repaid the sum to the firm) was subsequently charged with fraud by federal prosecutors. Refco's share price collapsed as it revealed that financial statements going back to 2002 were unreliable. See article

Antonio Fazio defended his conduct in the takeover battle for Banca Antonveneta. The governor of Italy's central bank was questioned by prosecutors investigating whether he had abused his powers by apparently favouring a domestic offer (ABN Amro, a Dutch bank, eventually won the bid). No charges have been brought against Mr Fazio.

Lincoln National, an insurance company based in Philadelphia, announced a $7.5 billion merger with **Jefferson-Pilot**, a rival from North Carolina. The deal creates America's fourth-biggest life insurer.

At a meeting of trade ministers in Zurich, Rob Portman, the United States' trade negotiator, said he was prepared to offer major concessions to reduce **farm subsidies**. The EU responded with somewhat less ambitious proposals. See article

Chasing dragons

China's trade surplus in September fell to $7.6 billion from $10.6 billion in August. For the 12 months ending September, the surplus was $96.4 billion. Imports to China grew sharply for the second month, a sign that domestic demand may be picking up. China released the figures just before John Snow, America's treasury secretary, arrived to seek further flexibility on its currency policy. See article

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Economist.com OPINION

The Federal Reserve

A hard act to follow

Oct 13th 2005
From The Economist print edition

Who could fill Alan Greenspan's shoes?

ON THE ground floor of the Federal Reserve building in Washington, DC, there is an electronic game which tests a visitor's skill at setting interest rates. You have to decide how to respond to events such as rising inflation or a stockmarket crash. If you get all the answers right, the machine declares you the next Fed chairman. In real life, because of huge uncertainties about data and how the economy works, there is no obviously right answer to the question of when to change interest rates. Nor is there any easy test of who will make the best Fed chairman. So who would *The Economist* select for the job?

Alan Greenspan will retire as Fed chairman on January 31st, after a mere 18 ½ years in the job. So George Bush needs to nominate a successor soon. Mr Bush has a penchant for picking his pals to fill top jobs: last week he nominated his personal lawyer Harriet Miers to the Supreme Court (see article). But his personal bank manager really would not cut the mustard as Fed chairman. This is the most important economic-policy job in America—indeed in the whole world. The Fed chairman sets interest rates with the aim of controlling inflation, which in turn helps determine the value of the dollar, the world's main reserve currency. It is hardly surprising that financial markets worldwide can rise or fall on his every word.

Financial markets are typically more volatile during the first year after the handover to a new chairman than during the rest of his tenure. In October 1987, barely two months after Mr Greenspan took office, the stockmarket crashed. Current conditions for a handover are hardly ideal. America's economy has never looked so unbalanced, with a negative household savings rate, a housing bubble, a hefty budget deficit, a record current-account deficit and rising inflation. Figures due on October 14th are expected to show that the 12-month rate of inflation has risen above 4%—its highest since 1991.

Monetary magic

Because Mr Greenspan is widely rated by investors as the greatest central banker ever, their confidence in his mystical powers has helped to hold down bond yields and prop up the dollar. But combine America's domestic and external financial deficits with a looming “Greenspan deficit” next year and markets could well push down the dollar and push up bond yields, thereby bursting the housing bubble. With inflationary pressures rising, the new Fed chairman will need to push short-term interest rates higher; there will be much less room to cut rates later, as Mr Greenspan did after the stockmarket bubble burst in 2001. Would any sane person want this job?

It is worth recalling that in 1987 many doubted whether Mr Greenspan could fill Paul Volcker's shoes. The skills required of a Fed chairman are indeed demanding. He or she needs to be an expert in monetary policy, have a good instinct for economic data and an insight into the big policy debates. A chairman must be respected by financial markets, able to keep a cool head in crises, and be politically independent, while well attuned to political opinion. Mere mortals need not apply.

All the main candidates commonly touted are highly respected economists who could be trusted to pursue a sound monetary policy, and yet each also has serious drawbacks (see article). President Bush said last week that he is looking for a successor to Mr Greenspan who would be seen as politically independent and who would thus inspire global confidence. Yet the leading candidates have all advised or worked for Mr Bush. Mr Greenspan, of course, also has close Republican ties, but financial markets will be less forgiving of his replacement. Any suspicion that Mr Bush has selected someone simply because he is a loyal Republican would undermine confidence in the next chairman, even before he takes office.

Expert and independent

If Mr Bush means what he says about the next chairman being politically independent, then we believe the best choice would be Don Kohn, a governor on the Federal Reserve Board, who is not affiliated to any party. Mr Kohn has another big advantage. As a staff member before being promoted to governor in 2002 on Mr Greenspan's recommendation, Mr Kohn has been attending the Fed's policy-making meetings for almost 24 years, even longer than Mr Greenspan. His vast experience of monetary-policy decisions and financial crises would be invaluable in troubled times. He is highly regarded by economists in the Fed and on Wall Street, and having worked with Mr Greenspan for so long, his thinking on interest-rate policy and financial markets is also close to the chairman's. He would offer continuity and a safe pair of hands.

Yet how can *The Economist* endorse Mr Greenspan's right-hand man, when we have long criticised the chairman for failing to curb the stockmarket bubble in the late 1990s, and later for propping up the economy by inflating a housing bubble? The answer is that the maestro seems to be changing his tune. In several recent speeches Mr Greenspan has expressed concern about the housing market and, in an apparent effort to talk it down, gave warning that prices could fall. There is a stronger case for restraining housing bubbles than stockmarket bubbles, because they tend to cause greater economic harm when they burst. His public view on the link between monetary policy and asset prices has also shifted. He now concedes that the Fed's success in delivering low inflation and interest rates may have made bubbles more likely, ironically, because investors are demanding less compensation for risk.

Whether central banks should respond to asset-price bubbles is one of the hottest debates in monetary policy. The Fed's failure to curb bubbles, while aggressively easing policy when they burst, is partly to blame for America's imbalances, which could give the next Fed chairman a lot of

grief. Mr Kohn's experience within the Fed makes him the best man to cope with this. Mr Greenspan could help him immeasurably and enhance his own legacy by going much further, and explicitly supporting the view of many other central banks that sometimes policymakers should act to restrain asset-price booms. When you are the world's greatest central banker, after all, you should be able to admit the odd mistake.

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The Kashmir earthquake

A double tragedy

Oct 13th 2005
From The Economist print edition

AFP

The disaster in Kashmir is a terrible waste, both of human life and of a chance for reconciliation

IT IS an ugly truth that tragedy falls disproportionately on the poor. Diarrhoea kills millions of people every year in developing countries, but few in the rich ones because of clean water and the easy availability of elementary drugs. Floods kill tens of thousands across Asia, Africa and South America every year—but, *pace* Katrina, seldom more than a few hundred in North America or Europe. And so it is with earthquakes. This week's quake in Pakistani-administered Kashmir was of magnitude 7.6, yet may have killed as many as 30,000 people or more. The earthquake in Gujarat in India in 2001, which was of similar magnitude, killed some 20,000. Yet larger quakes than Kashmir's, in San Francisco in 1906 and in Taiwan in 1999, killed far fewer—3,000 and 2,300 respectively, even though they happened in heavily populated areas. The Kobe earthquake of 1995 happened in one of the most densely populated places on earth, and killed only 6,400.

The reasons are obvious enough: more stringent building codes, rigorously enforced; and more rapid and effective rescue efforts after the event. Such things, of course, cost money. And for poor countries like India and Pakistan, there are a thousand urgently competing priorities for extremely limited government resources. Both have rapidly increasing populations, and cheap housing is in huge demand. Literacy, sanitation and electrification might all very well be considered better uses of taxpayers' rupees than guarding against disasters that could strike anywhere, or not at all. Might not earthquakes simply be too expensive, and too mercifully infrequent, a problem to be worth poor countries doing very much about? After all, in the last 25 years, earthquakes have killed “only” about 500,000 people worldwide—300,000 of them in the tsunami on December 26th last year. Yet 2m children under the age of five die every year in India alone, mostly thanks to poor nutrition or bad drinking water.

Fatalism in the face of the earth's convulsions, however, may no longer be appropriate, for two

reasons. The first is that the danger posed by earthquakes to the northern subcontinent is greater than is often assumed. The mighty Himalayas are testament to the awesome forces being unleashed as the subcontinent continues its 40 million-year-long collision with the Eurasian landmass. Some of that energy has to be dissipated in the form of earthquakes, and recent studies (see article andsee article) suggest a much bigger quake is long overdue. Yet since the last big Himalayan quake, in 1950, India's population has trebled and urbanised. Delhi, population 14m, and Lahore, population 6m, lie well within the danger zone.

The second argument against fatalism is that there are new and relatively inexpensive techniques that might lessen the blow. Earthquake proofing to Tokyo standards might be out of reach, but there are much cheaper things that can be done that would at least prevent buildings from collapsing in lesser earthquakes. One study, done in India, suggests that for as little as an additional 2-4% of cost, a building can be made significantly better able to withstand vibration. Existing buildings can be “retrofitted”, but that costs two to three times as much.

The other key point is that these measures need not be applied universally. Much benefit would be derived from targeting the most important buildings—those whose survival is essential to any relief effort, such as hospitals, police and fire stations; and high-density precious locations like schools. And planning for swifter and better co-ordinated earthquake relief than the chaotic scenes now being witnessed in Pakistan need not cost much at all: for a country as militarised as Pakistan to be handling the aftermath so badly is a disgrace. The Gujarat earthquake four years ago should have sent these lessons to India, Pakistan and the wider world, yet it needs repeating: hundreds of thousands of lives could potentially be saved for affordable cost. If that is now learned, some good may have come from Kashmir's agony.

The waste of it

If only it were possible to say the same about the other, slower-burning catastrophe that afflicts Kashmir: the long war, both cold and hot, between India and Pakistan for the former princely state. Earthquakes have sometimes acted to bring peace out of horror, underlining in the most graphic way the impermanence not just of human territorial divisions but of the earth itself. The tsunami, caused by an earthquake of appalling violence, brought forth unprecedented generosity from around the world. In the civil war-wracked Indonesian province of Aceh, which bore the brunt of the destruction, it has been the catalyst for peace. In Sri Lanka, which also suffered badly, the need to work out how to spend the aid money drew the government and the Tamil Tigers into compromise, though progress has since faltered. And the 1999 earthquake in Turkey did a great deal to patch up relations between Turks and their hugely compassionate Greek neighbours.

So it is an additional tragedy for Kashmir that the earthquake has not, so far at least, called forth similar generosity of spirit from the rulers of Pakistan and India. India did immediately offer to send relief supplies and, on October 11th, a full three days after the earthquake, a small consignment arrived in Pakistan. But—and the blame here mainly seems to be Pakistan's—there has been no agreement to open the line of control, which divides Indian- from Pakistani-administered Kashmir, to make rescue work easier or swifter. India proposed joint search-and-rescue operations across the line, but has been rebuffed. Likewise an offer of helicopters, more urgently needed than anything else, has not been taken up, apparently for fear of the symbolism that Indian army uniforms on Pakistani soil would represent. (American helicopters apparently pose no problem, and the Americans should have sent more of them more quickly.)

Ordinary Kashmiris, keen to help their fellows across the line, have also not been allowed to cross. The earthquake, which in a couple of minutes killed almost half as many people as the insurgency in Kashmir has killed in 15 years, ought to be reminding both countries' rulers of the pettiness of their disputes. It is a matter of sadness that, so far, it hasn't.

Farm trade

To Doha's rescue

Oct 13th 2005
From The Economist print edition

Alamy

America's offer should boost the Doha trade round—if Japan and Europe respond in kind

Get article background

IT HAS been an awfully long time coming—but then the trouble with rounds of trade-liberalisation talks is that there are no real deadlines. Even so, the offer this week of cuts in farm protection by America's trade representative, Rob Portman, promises to jolt the current Doha round of trade talks out of their slumbers. It won't guarantee success at the next big ministerial meeting in the World Trade Organisation (WTO), in Hong Kong in December. But as a clear statement that America is serious about achieving an agreement over farm trade, following months during which American minds seemed to be focused elsewhere, Mr Portman's offer has suddenly made it plausible that the round could be completed during 2006—as long as the other rich-country farm protectionists, Japan and the European Union, produce comparable proposals. Which they must, if they really want to keep the WTO healthy and to prevent a revolt against freer trade.

The initial response from Japan—that America's offer changed nothing—was not encouraging. But that may merely be the reflexive action of trade negotiators who have not yet felt the effect of Japan's dramatic general election on September 11th, in which the balance of the ruling Liberal Democratic Party shifted decisively away from rural parliamentarians to urban ones, weakening the farm lobby's power. The European Union's response was more nuanced, showing some flexibility but not as much as Mr Portman called for. That may well reflect the EU's decision-making structure, however: Peter Mandelson, the European commissioner for trade, needs approval from national governments if he is to go as far as his American counterpart has demanded. Securing that, with the French government feeling vulnerable and the German one not yet formed, will take time.

But it must be done. Everyone knows that farm protection in Europe, America and Japan is a costly throwback to the past, one that does great damage to the rich countries' relationship with

the poorer world, especially in Africa, and that by raising prices acts as a tax on ordinary consumers. Dismantling subsidy systems and cutting farm tariffs is not easy, given farmers' well-honed political tactics and many countries' sentimental attachment to the idea of food security. Like all disarmament negotiations, however, it is made easier if all the great powers are willing to lay down some of their arms.

America's proposal is a serious step in that direction. It is not quite as dramatic as it seems (see article): the 60% reduction offered in the most trade-distorting support disguises some transfers to other forms of subsidy, and the cuts pledged in spending are from allowable ceilings rather than actual sums being spent. But the point is that the proposal is large enough to send a strong signal. As long as other rich countries—and the developing world—play their parts, Doha is not dead—thank goodness.

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Iraq's constitution

A ballot that matters

Oct 13th 2005
From The Economist print edition

EPA

Iraqis should vote in their referendum, even to say no. But a yes would be better

Get article background

IT IS another dramatic milestone along Iraq's rocky, blood-spattered road towards some kind of democracy. This weekend, its people will decide, by referendum, whether to accept an imperfect but workable new constitution. If they say yes, it will pave the way to a new form of governance that will be the most federal and decentralised in the Middle East, establish a fair set of rights and values, and, with luck, provide for a better life for all Iraqis. If a large enough minority (two-thirds of voters in at least three of Iraq's 18 provinces) says no, the document will be blocked. After a new parliament has been elected, a new lot of drafters would then be sent back to the drawing board. Yet genuine comfort may still be drawn if it is clear that all three of Iraq's main strands—Arab Sunnis, Arab Shias and Kurds—actually went to the polls in large numbers.

Persuading Iraq's disaffected Sunni Arabs to vote at all is as important as persuading them to vote yes. For by participating in peaceful politics, they are half-turning their backs on the remorseless insurgency, or at least on the most vicious part of it, whose leaders have told Iraqis not to vote. It is vital for Iraq's emerging new order, struggling to assert itself, that it manages to divide the insurgents and reach out to the Sunni nationalists whose followers are increasingly alienated by the mass suicide-bombings and beheadings perpetrated by the jihadists. In any event, whether Iraqis say yes or no this weekend, they are due to vote for a new parliament by the end of the year. Whether or not this constitution is agreed upon, a new electoral system, relying on proportional representation for provincial lists, should ensure that Sunni Arabs, underrepresented in today's parliament because of their mass stay-away in January's general election, will have a stronger voice.

The document to be voted on has flaws. Its article dealing with the allocation of oil revenue has worrying ambiguities that could be abused by Shias and Kurds sitting on the oil fields. And Sunnis

fear that the southern and central Shias could use the proposed constitution to create a Shia “super-region”, of as many as nine provinces, that would look very much like the start of Iraq's fragmentation into three parts.

Other Sunni grievances, however, are either overblown or have been at least partially addressed by last-minute tweaks. The fastidious assertion that “Iraq's Arab people are part of the Arab nation”—an important formulation for the Kurds but a supposed humiliation for Arab Sunnis by denying them Iraq's unqualified Arab identity—has been softened by an assurance that Iraq will be “bound by the Arab League's charter” and by a last-minute addition confirming that Iraq belongs to the “Arab and Muslim world”. The banning of a specifically “Saddamite” Baath party allows for a rebranded party with Baathist ideas to emerge, though many Sunnis still complain that deBaathification, implicit in the document, will mean discrimination against the 1m-odd former members of the party, in which Sunnis were disproportionately numerous.

Make the best of it, then

Such worries, though understandable, may be exaggerated. But, even in the final run-up to the referendum (or after it, if need be), parliament should give firm reassurances to former Baathists that only those with blood on their hands have anything to fear. No less important, parliament should declare that no region can comprise more than four provinces, so allaying Sunnis' palpable fears of a Shia super-region that might leave them to rot in their much poorer provinces. Once a new parliament has met, it should clarify and amend the articles concerning the fair distribution of oil revenue to ensure that the Sunnis' oil-dry areas are not done down. The current parliament now wisely says it may further amend the document, to reassure the Sunnis, before the election due in December.

As things stand, many Sunnis still feel left out. Iraq's disintegration along ethno-sectarian lines is still possible. Under the new constitution, provinces and regions will run the police and gendarmerie, fostering a further worry that sectarian militias may rule local roosts. Meanwhile, a bitterly divisive war goes on apace—and may get bloodier in the next few days.

Still, this latest voting milestone spells hope. In January, people across the world, especially in neighbouring Arab countries, were flabbergasted by the determination of so many Iraqis to vote. At last, the Arab League may be urging its member countries, and Sunnis in Iraq, to support the process. If turnout is fairly high, the political momentum that gradually fizzled after January may be recovered. But Iraqis still need to try harder to clasp hands across sectarian barriers.

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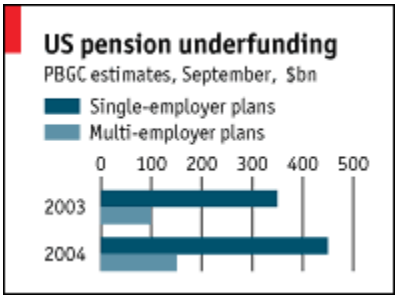
Economist.com OPINION

Legacy costs

The curse of promises past

Oct 13th 2005
From The Economist print edition

American companies must face the reality of their legacy costs



THE voluntary filing for bankruptcy of the world's biggest maker of car parts might not seem like an especially momentous event. But Delphi's decision on October 8th to seek the haven of Chapter 11 protection has ramifications far beyond its main customer base in Detroit, heartland of America's car industry. As well as symbolising the decline of once-mighty Motown (as recent bankruptcies have done for America's airlines), Delphi's surrender has triggered the first meaningful discussion of a problem that has been creeping up on American business for three decades: that of the unaffordable promises which successive waves of managers have made to meet the living and health-care costs of workers in their retirements.

As these massive costs have become evident, the “legacy” problem has begun to dwarf other challenges facing corporate America—even competition from China. Can firms meet their obligations? Or is the stage set for conflict as they abandon promises and try to bludgeon workers into accepting reduced benefits? A few years ago such questions might have seemed alarmist. Today, they are unavoidable (see article).

Delphi's plight has turned the spotlight on General Motors, its former parent, which guaranteed some of Delphi's pledges to retirees when it spun off the parts-maker in 1999. GM encapsulates the legacy problems that are most severe in, but not confined to, older industries. It has fewer than 200,000 American workers, but nearly 1m retirees and dependants. Its $15 billion stockmarket value is half the size of its unfunded pension liabilities, which in turn are dwarfed by an estimated $70 billion of unfunded health-care liabilities. And these are estimates—the final costs could be much larger, because reality will probably diverge from hopeful actuarial assumptions.

This is a crippling burden for GM as it struggles to compete with Japanese rivals. It has tried to lay off workers and shut factories. But trade unions, notably the United Auto Workers, have been so tenacious that workers are often expensively idled rather than sacked. Investors who fret about GM's decline tend to forget that they, too, have had a hand in this. Under pressure from shareholders, the firm paid out billions in dividends and share buybacks that it sorely needed for investment. GM could soon follow Delphi into bankruptcy.

The really bad news for corporate America, however, is that the legacy problem is widespread (much more so than in Britain and continental Europe, for example). Three-quarters of the country's biggest public companies have defined-benefit pension funds of the kind that have fallen into serious deficit. Provision of health insurance, although not always open-ended, has been a way to attract and appease workers who know there is state provision only in extreme situations.

Called to account today

What can be done? The first thing is to acknowledge that the problem is huge, growing and not susceptible to a quick fix. A couple of helpful measures are relatively obvious, but seem depressingly distant. America should standardise its rules for how companies account for their retirement pledges. Marking-to-market of pension assets matched by application of a set discount rate for bond-like liabilities would make the pension issue more transparent, as well as encourage better management and more sensible asset allocation (ie, fewer equities). Similarly, a transition towards risk-based premiums for the insurance provided by the federally-backed Pensions Benefit Guaranty Corporation would create proper incentives for managers and trustees to reduce the riskiness of their funds.

Other solutions are much more fraught. America should expand forthcoming reforms of its bankruptcy code, stopping abuses of Chapter 11 provisions that allow malingerers to stay in protection and thereby harm competitors, and perhaps forcing more failing companies into liquidation. That will require the sort of political will neither major party has yet demonstrated. The same applies to health-care promises. Congress should force firms to fund their liabilities. Many firms might then have to admit the truth: that they simply cannot keep their promises. Workers would have to buy their own health insurance. This would revive debate about America's lack of a government-backed universal health-care scheme. Whether or not the country should go down that route, it would be helpful if such a complex long-term issue were no longer distorted by false short-term promises made by big companies.

Legacy problems have arisen because, aided by a lax accounting regime and the collusion of shareholders and trade unions, past generations of managers were able to fudge painful decisions and shift the burden of their promises far into the future. Delphi's failure is a signal that the time of reckoning has arrived. Tough decisions have to be taken. Sorting it all out will be neither pretty nor easy.

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Economist.com OPINION

The Conservative Party

Hope over experience

Oct 13th 2005
From The Economist print edition

The choice to lead Britain's Conservative Party

Get article background

IT IS a mighty odd business. Next week the votes of just 198 men and women will help determine an election setting out to identify a man they hope will be a future British prime minister. They are as sophisticated an electorate as you could find, yet over the past 15 years they and their party have fallen into a dismal habit of backing the wrong man and the entire country has suffered because of it. Now is their chance to put that right.

The procedure for picking the next Conservative leader is strictly for enthusiasts. In a pair of elimination contests starting on Tuesday, Tory MPs will select two names to go before the party's 250,000 or so members, who will then have until December 5th to choose their man—there are no women.

But all Britons, whatever their politics, have a stake in the result. In a system of government that confers huge power on the ruling party, Labour's political dominance is unhealthy. Its restless urge to legislate, its faith in the bureaucracy's capacity to “manage” its way around complex problems and its erosion of civil liberties have been barely challenged in the House of Commons. The arrogance of office is a trap for all long-lived governments. The next Tory leader should first of all be the man best able to make his party an attractive alternative.

Whoever wins the prize, the shudder of excitement at the race to replace the hapless Michael Howard as leader is a rare piece of luck. The party conference earlier this month was a scene of unlikely drama when David Davis, the front-runner, stumbled through a speech that could not match the oratory of the most untested candidate, David Cameron. Veteran Ken Clarke tore into Labour's style of government with more gusto and precision than any frontbench spokesman in a decade. Liam Fox, the shadow foreign secretary, pitched to the right of the party. Even Sir Malcolm Rifkind, whose withdrawal from the race this week signalled his outsider's status, spoke

with enough wit to convince Tory activists that their party had the talent if only it could be harnessed. For the first time since the traumatic ousting of Margaret Thatcher in 1990, the Tories looked as if they might be beginning to believe in themselves.

And about time, too. Years of in-fighting and score-settling, a series of broken leaders and, above all, a failure to understand Tony Blair's reshaping of politics have poisoned Tories' relations with voters. By seizing the centre, Mr Blair has cast Tories as mean and selfish, and Tories have often played the part. Polls show that policies which voters quite like are spurned when they are identified as Conservative policies. An electoral pledge to cut taxes won few votes, partly because people didn't believe it. Nobody will listen to the nasty party until they begin to think of it as nice again.

But broad voter appeal is not enough. The Conservative Party itself needs rebuilding, too. Entire parts of urban and northern England are bereft of Tory blue. A single MP represents the whole of Scotland. At Westminster the party needs discipline. Outside, it needs think-tanks and pressure groups to channel donors, ideas and potential supporters towards the party. In the country, it needs candidates who defy the stereotype. Only then will the new leader be placed for the battle of policy—to make the case for less government and lower taxes, for more reform of public services, for civil liberties. And only then will he be able to resist his predecessors' inclination to tack at the first sign of trouble towards positions that are xenophobic, socially conservative—and unelectable.

The past is a foreign country

Put like that, MPs and party members face a difficult choice. If only the Conservatives could call on the organisational skill of a machine politician and former whip like Mr Davis, the blokeish appeal and destructive oratory of Mr Clarke and the charm and fresh allure of Mr Cameron (see article).

But they cannot and so the party must choose. Mr Fox lacks stature. Mr Davis is short of the charm he needs to shed the party's charge of nastiness. Mr Clarke, virtually absent from politics for the past eight years, lacks a claim to lead—and renewal is hardly the word for a politician who has yet to show that his policies and persona have moved beyond the 1990s.

Which is why the party should elect Mr Cameron. True, at 39 his moment has come too early. Although he has years of experience as a political adviser, he has much to learn about politics in the front line. But he has intelligence, charisma and (it seems) integrity. And he alone has shown that he has come to terms with New Labour—that he knows which parts of it voters like and which to jettison. That makes him best placed to give the Tories hope and Britain an opposition.

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Economist.com OPINION

Germany

Angela Merkel's chance

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From The Economist print edition

Getty Images

A grand coalition needs to implement reform, and then sell it

Get article background

THE new chancellor looks utterly different from all Germany's post-war leaders—and not just for the obvious reasons. What separates Angela Merkel from her predecessors is not so much her sex, her relative youth (at 51), her preference for quiet methodical work over snazzy media savvy, or even her east German background. Ms Merkel's real distinguishing mark is the fact that she is a tough-minded liberal, in a country where the establishment remains soggily social-democratic. She genuinely believes in clearing away the obstacles that are preventing Europe's biggest economy from realising its potential—and is prepared to take political risks to do so. Indeed, were she a more cynical sort of politician, prepared to offer sops to special interests and lobbies, she might now be forming a centre-right government on her own, instead of presiding over a tortuous effort to construct a left-right coalition.

Ms Merkel's personal qualities, and her steady principles, are all welcome as far as they go. But the risk is that the good news from Germany may end there. That is not because left-right coalitions are a bad thing in themselves. German politicians are adept players at a bizarre political game in which they take turns to compete furiously and co-operate closely, and the result is not always disastrous. The last grand left-right coalition, in 1966-69, managed to do some useful things—though in part, perhaps, because the stark imperatives of the cold war, and a divided nation, laid heavy responsibilities on all elected politicians.

But rightly or wrongly, Germany's pundits seem pessimistic about Ms Merkel's ability to hold a broad coalition together—or if she does hang on, to achieve anything of lasting value. Some gleefully point to the defects of the last left-right government: the fact that it often chose easy options over costly ones, and drove disgruntled voters into the arms of extremists or away from

parliamentary politics (see article). Other gloom-mongers predict the Christian Democrats (CDU) and their Christian Social Union (CSU) partners will agree with the Social Democrats (SPD) only on a bare-bones agenda—while each side concentrates on getting ready for a clear victory in another election.

Yet the new grand coalition needn't be a failure, especially if negotiators, who hold their first serious talks on October 17th, get two things right. One is personnel: if the first grand coalition was a partial success, it was mainly because Karl Schiller, an SPD economics minister, and Franz Josef Strauss, a CSU finance minister, respected each other and did good things together. The second condition for success is a properly reforming policy programme. However, the biggest challenge will come only once the government has been formed: it is that of convincing Germans they need economic reform, and then making them feel better about it.

On the human front, the two camps seem to be able to work together without coming to blows; the party bosses on each side like and understand one other. But the pleasant working relations between the SPD's Franz Müntefering and the centre-right's Edmund Stoiber are a mixed blessing. Between them they might try to neutralise the healthy nettle-grasping of Ms Merkel. Both seem intent on turning her into little more than a moderator; there is talk of watering down the chancellor's role in setting policy.

Look at the government agenda that is emerging, and the signs are even gloomier. The party bosses have already shelved the main elements of Ms Merkel's proposed reform programme: a flat-fee health-care premium to lower non-wage labour costs; further labour-market reforms, such as loosening Germany's strict protections against dismissal; and radical tax reform. Instead, they appear to prefer pussy-footing reforms, little more than a continuation of the Agenda 2010 reform package devised by the outgoing chancellor, Gerhard Schröder: subsidy and other budget cuts to trim the public deficit and conform to euro-zone rules; simplifying the tax system; and constitutional change to disentangle the federal and regional tiers of government.

With its massive majority, the new coalition should be aiming for something bolder. Sorting out the process for taking political decisions is perfectly sensible. But there is a far tougher job to do that is no less urgent: simplifying the country's “financial constitution”, an inefficient cobweb of tax-revenue equalisation and joint public spending. And, more important than further labour-market reforms and cutting red tape, the new government needs to deal with the underbelly of Germany Inc: the vast network of often hidden subsidies and protections that keep the services industry, in particular, from becoming more efficient and creating new jobs.

Nerves of steel

To do all that, the new government will need to do what its predecessor stumbled over: to convince Germans that the aim of reform is not to inflict pain, but to restart the economy and generate the funds for badly needed investment in education, technology and utilities. That, in the end, is the only way that Germans can preserve the “social balance” which many hold dear. A grand coalition ought to be well placed to get the message across, assuming it had the vision and boldness to try. Then, Germans might snap out of their depression and come to see globalisation as an opportunity not a threat.

Unfortunately, communication is Ms Merkel's weak spot. An ideal leader would combine her principles with Mr Schröder's slickness. A more realistic hope is that some of Ms Merkel's other qualities will come to the fore. She is a fast learner—and has steelier nerves than her male opponents. If, as many worry, her government ends up paralysed in a year or two, she could and should seek new elections, in the hope of gaining a clear majority. Between now and then, she will need to face down reluctant coalition partners with the determination that has neutralised rivals

on the centre-right.

The result could be a pleasant surprise. At the start of the election campaign, *The Economist* wrote that Germany's economy could soon defy the general prognosis of gloom. Ms Merkel might yet inject some spirit into its politics too.

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On America's economy, the Dubai International Financial Exchange, hookahs, sugar, Puerto Rico, Donald Rumsfeld, Freud

Oct 13th 2005
From The Economist print edition

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FAX: 020 7839 2968 E-MAIL: letters@economist.com

In for a penny

SIR – I read your survey on the world economy with some interest (September 24th). I was particularly struck by the similarities between the issues facing the United States today and those being hotly debated in Britain in the early 1960s. Then, the debate turned more on the problems caused by sterling as a reserve currency than on investment and savings imbalances. Nevertheless, at that time Britain was a relatively rich and flabby country that had lived beyond its means for many years and had its investment and trade deficits financed by the (then) sterling area, probably to the disadvantage of the countries concerned (a similar relationship exists between America and China today).

The eventual outcome was a faltering economy brought on by a series of trade balance crises leading to an inexorable devaluation of sterling over a long period. Much of the damage was caused by Britain's inability to macro-manage its economy through interest rates because of the influence and conflicting objectives of international holders of sterling. Remember the “gnomes of Zurich”? The process finally left Britain poorer, but leaner and meaner and at last able to successfully macro-manage its economy untroubled by external reserve-currency issues. Could this portend the future for the United States?

David Scott
Loughborough, Leicestershire

Dubai's financial exchange

SIR – Your article about the launch of the Dubai International Financial Exchange quotes allegations of a “poor disclosure of a commercial conflict of interest” on my part and goes on to say that “management denies wrongdoing”, as if it is just one person's word against another (“Do buy, do sell”, October 1st). Your readers will be naturally left with the nagging suspicion that there can be no smoke without fire. In this particular case, despite enthusiastic fanning by one or two tabloid journalists, I can assure you that behind the smoke there are not even dying embers. The allegations have no foundation whatsoever in fact. This is not just the position of management but of the board of the DIFX as a whole, the members of which include some very eminent individuals from the international financial services community. The launch of the DIFX is a major step forward in the evolution of the financial markets of the Middle East. Serious journals should not let its importance be obscured by trivial, unfounded accusations.

Lynton Jones
Chairman, Dubai International Financial Exchange
Dubai

Café culture

SIR – Far from sticking to simple flavours like grape or melon, there are at least 20 Egyptian- or Bahrainian-made flavours for hookahs (also known as water pipes, *shisha* or *nargilehs*) available in Arabic stores in Athens alone ("Smoke like an Egyptian", September 24th). There are many more flavours in Egypt, including cappuccino.

Paul Papadopoulos
Athens

Sweet truth

SIR – Your article on the devastating impact of EU sugar "reform" on the Caribbean, though welcome, contained some distorted thinking ("Living and dying on history and artificial economic sweeteners", September 24th). The EU-ACP [Africa, the Caribbean and Pacific] sugar protocol, which allows for preferential access to the EU, is an integral part of the EU sugar regime. But it is quite disingenuous to link ACP quotas with the perceived unfairness of the sugar regime. It is also completely wrong to state that the World Trade Organisation found the regime unfair, when it actually ruled against EU subsidised exports over the 1.273m tonnes established in the 1994 Uruguay round agreement.

Moreover, you parrot the patronising line about Caribbean economies having a future as service centres. Economic transformation takes time and comes at a huge social cost. Like the pro-reformists in Europe, you ignore the social and economic realities of the region. Reform implies a change for the better. Caribbean sugar producers are therefore calling for a reasonable approach, with price cuts phased in over eight years from 2008, and with adequate EU funding to cushion the effects.

Ian McDonald
Sugar Association of the Caribbean
Georgetown, Guyana

Island stories

SIR – Your obituary on Filiberto Ojeda Ríos gives too much credit to a delusional thug that the vast majority of Puerto Ricans don't want to be associated with and vastly overstates our sympathy for "a romantic who would fight for his little island" (October 1st). Not even staunch *independentistas* buy the story that this cheap loser "fought" for us. Mr Ojeda Ríos sought to become a legend and live tax-free from the millions he robbed (the irony of living off stolen American dollars he claimed to loathe never crossed his mind). He had a free ride while the rest of us struggled to make ends meet. It is hard for non-Puerto Ricans to understand the embarrassment Mr Ojeda Ríos, and his fellow *Macheteros*, brought to decent, hard-working, intelligent people on the island, who greatly appreciate the advantages of being annexed to the United States. May God forgive his polyester socks.

R. Ramos
Miami Beach, Florida

SIR – It is often repeated that Puerto Ricans do not seek independence. But this is because the United States has been actively involved in suppressing the independence movement. From the invasion in 1898 through the Ponce massacre in 1937 and the persecution of Don Pedro Campos to the birth of the commonwealth and thereafter, Puerto Ricans have been cowed into not openly

endorsing independence.

Paulino Ruíz-Roman
Hartsdale, New York

A tot of Rummy

SIR – I take exception to you mentioning Donald Rumsfeld in the same context as Michael Brown, the former head of the Federal Emergency Management Agency, implying a similar incompetence ("What's gone wrong for America's right", October 1st). One needs only to read Mr Rumsfeld's online biography at the Pentagon to see that he is eminently qualified for his position as defence secretary. There is no exaggeration of his accomplishments in over 50 years of service in both the public and private sectors. He currently manages the military efforts in Afghanistan, the insurgency in Iraq, an international war on terror and is transforming the American military. I am not writing to address the policy or rationale of the war in Iraq as Mr Rumsfeld is but one of many advisers to George Bush and is not solely responsible for American foreign policy.

Peter Schneider
Santa Rosa, California

Clothing argument

SIR – Krishna Prasad ponders a Freudian connection to the headline of your article on imported Chinese bras (Letters, October 1st). I was under the impression that Freud dealt with slips, not bras.

Rama Rao
Irvine, California

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Kashmir's earthquake

The mountain tsunami

Oct 13th 2005 | BALAKOT, ISLAMABAD, MUZAFFARABAD
From The Economist print edition

AFP

A region long tortured by man-made conflict suffers natural catastrophe

Get article background

WHEN they spoke in the past of the growing irrelevance of international borders, this is not what the leaders of India and Pakistan had in mind. They meant the march of globalisation. But their countries have always been linked by far more primordial forces. The epicentre of the huge earthquake that struck them on the morning of October 8th was near Muzaffarabad, the capital of Pakistani-administered Kashmir. But it was also felt across the Indian-held part of the disputed territory, as well as in Afghanistan to the north and as far south as India's capital, Delhi.

It was in Kashmir and northern Pakistan, however, that it wrought devastation. It was, said Shaukat Aziz, Pakistan's prime minister, “a disaster of unprecedented proportions in Pakistan's history”. Islamabad was badly shaken. In Muzaffarabad, a substantial city, two-thirds of the buildings were damaged. Balakot, a nearby town in the North-West Frontier Province (NWFP), was utterly flattened. Within five days of the quake, more than 23,000 people had been confirmed dead in Pakistan and 1,300 in Indian Kashmir.

The actual number of dead was likely to be much higher. Muhammad Wasi Zafar, the law minister, one of three cabinet ministers camping in Muzaffarabad to show the government's face, estimates that 30,000-40,000 have died in that area alone. Bodies are still buried in rubble. Rescue teams were only beginning helicopter searches of remote villages. From the air, inaccessible hilltop hamlets can be seen as mounds of debris. Some villages are said to have vanished under

landslides, as mountains seem to have split in two.

Mr Aziz clung to the hope that, because many people lived in flimsy mud-and corrugated-iron shacks, they might have survived their collapse. But the longer it took to reach the cut-off villages, the more those hopes dwindled. Abdul Karim from Ashkod, a village of 8,000 people near Muzaffarabad, said it was like hell there, with no household spared and food stocks exhausted.

It was only on October 11th that the army had begun to fan out beyond the towns. But unseasonable torrential rain and hail hampered relief efforts, grounding helicopters and causing fresh landslides. It also heralded a marked drop in the temperature. Priorities quickly shifted from rescuing the injured and feeding survivors to providing shelter. At least 1m were without it.

Already, in higher areas, snow has fallen. Mr Aziz's priorities for foreign assistance are food, tents, blankets, medical supplies and engineering equipment. Aid workers also worried about the spread of disease from the damage and contamination of water-supply and sewerage systems. Fresh drinking water is therefore another urgent need.

India and Pakistan are young countries, and many of the dead were children, who made up perhaps half the population of the worst-affected areas. Many died in their schools. Two days after the earthquake, Rizwan Hussein, headmaster of a girls' school in Muzaffarabad, watched a group of soldiers unearthing bodies from the ruins with a mechanical digger. Out of 60 children buried there, 30 had been exhumed. His wife, a teacher, was also lost, and his brother driven berserk by grief. Mr Hussein ferried anguished parents, clasping their children's bodies, home on the back of his motorbike. Elsewhere, there were often no parents to claim the bodies.

There was also anger with what was seen as the slowness of the government's response to the disaster. In Balakot, to which the road was opened only on October 10th, residents complained that the army spent its first day there building its own camp. In Muzaffarabad, Chowdhry Chanzub, the owner of what was a four-storey hotel, now a crumbling ruin, said he saw no sign of the army for three days. He had been entertaining a party of tourists from Karachi, Pakistan's commercial capital. The wrecked hotel now housed 50 corpses. Looters had rifled their pockets. The head and torso of one young man protruded from the slab of fallen concrete that had crushed him. Local people were trying to lift it off him, using a car-jack and wooden wedges.

In Muzaffarabad, anger was sharpened by Kashmiris' sense of alienation. Some complained of discrimination, claiming, unfairly, that relief was going faster to “Pakistanis” in NWFP. In Indian-held Kashmir, too, there were complaints about delays. Both governments could plead mitigating circumstances: the strength of the quake and the ruggedness of the mountainous terrain, made even more inaccessible by landslides. Helicopters became essential, and there were not enough. More are coming.

AP

Pakistan's president, Pervez Musharraf, knowing the quake will weaken his authority, testily defended the government's performance. But it did look as though the army was slow off the mark. Only on October 12th did two divisions of fresh soldiers from Punjab province start arriving in Kashmir and NWFP. Many also criticised the poor co-ordination between military and civilian authorities. But the army, too, had suffered heavy losses—432 soldiers confirmed killed. Some 100 died in the main army-run hospital in Muzaffarabad. Bodies were strewn all around its lawns and whitewashed bungalows.

Pulling together

For Mr Aziz, the prime minister, the earthquake had one positive effect: the outpouring of sympathy and solidarity for the victims from around the world, but especially among Pakistanis, who, he said, had “gelled and galvanised”. The political opposition called a sort of truce, although, as criticism of the relief effort mounts, that may not last long.

In the short term, however, everybody wants to do his bit. In the evenings, Mr Aziz's palatial official residence is like a royal court, where the great and good wait in antechambers to present their donations. The poor and the young have also joined in. In Islamabad, middle-class schoolchildren are working as volunteers at local hospitals, or are going house-to-house to raise funds for what they called the “mountain tsunami”. Amateur do-gooders so clogged the roads to Balakot and Muzaffarabad, taking car-loads of assistance, that they unfortunately delayed the lorry-loads.

The flowering of private philanthropy, in the holy fasting month of Ramadan, may even mitigate some of the fiscal damage done by the disaster. Mr Aziz does not expect it to have a big impact on Pakistan's economic performance, which is currently very robust, with an annual GDP growth rate of more than 8%. But the rebuilding cost will be immense.

The earthquake's overall economic effects will probably be limited for the same reason it has proved so devastating for its victims: most of them are poor subsistence farmers, whose economic contribution is small, and who have no resources to fall back on. Sakib Sherani, an economist with ABN Amro in Islamabad, points out that most of Pakistan's economic infrastructure—highways, ports, dams, factories, power plants, oil refineries and so on—has been spared.

Foreign aid has also flowed, from both governments and private citizens. Within days more than $350m had been promised. Many Britons of Pakistani origin have family ties in Kashmir, and were quick to send help. The United Nations launched a “flash appeal” for $272m to cover six months' emergency supplies. Specialised rescue teams arrived from Britain, China, Dubai, France, Germany, Japan, Italy, Switzerland and elsewhere. America, for which Pakistan is a vital ally in the global campaign against terrorists, but which remains unpopular with many Pakistanis, was especially keen to help. To show this, Condoleezza Rice, the secretary of state, turned up in Islamabad on October 12th.

India also offered aid, which Pakistan accepted. It declined, however, the loan of some helicopters, and a suggestion of joint rescue operations along the “line of control” that divides Kashmir in the absence of an agreed international border. Tasnim Aslam, the foreign ministry's spokeswoman, said that the main centres of population were not along the line of control anyway. But there were also sensitivities about allowing Indian military personnel into Pakistani Kashmir. The offer “was not in the right spirit”.

Understandably, Ms Aslam refuses to speculate on the impact of the earthquake on the unfolding Indo-Pakistan peace process: “A humanitarian disaster of such proportions is not a time to think of politics. Our first priority is to save lives.” Mr Aziz says the quake will have “no impact on the relationship” with India.

That seems odd. Calamities change things. Last December's tsunami, for example, gave a helpful impetus to two peace processes: between Indonesia and rebels in its Aceh province, and (if only briefly) between the Sri Lankan government and Tamil Tigers. Moreover, Mr Aziz himself repeats the Pakistani mantra that Kashmir is “the core” of its dispute with India. Since independence and partition in 1947, Kashmir has already sparked two full-scale wars and one limited one.

Enduring suspicions

Since 2003 when both countries declared a ceasefire over the line of control, relations have improved out of all recognition. But India remains frustrated by what it says is Pakistan's continued stoking of an insurgency against its rule in Kashmir. And Pakistan remains suspicious that the “irrelevance” of borders that India's prime minister, Manmohan Singh, likes to plug is a euphemism for the status quo—continued Indian rule in its part of the territory.

In Indian Kashmir, Umar Farooq, a senior Muslim cleric, who is also an important separatist leader, appealed to the two governments not to let politics get in the way of cross-border relief efforts. He called for the opening of telephone links, as well as the swift repair of the road from Indian Kashmir to Muzaffarabad, and the damaged bridge at the border, across which, since April, fortnightly buses have reunited divided families.

Indian newspapers gave hope that the earthquake might mark a breakthrough of sorts: there were reports that training camps for militants in Pakistani Kashmir had been destroyed by the quake. India has long demanded that Pakistan “dismantle the infrastructure of terrorism”, meaning the camps and the militants' fund-raising networks. Mr Aziz is evasive: “We have always said there are no camps.” Whatever the truth, the disaster and the rebuilding effort may divert attention and funds from the *jihad* in Indian Kashmir.

At the very least, the fellow-feeling the catastrophe has generated makes the thought of another war between the two countries over Kashmir seem even more far-fetched. As the hail battered the homeless and the hungry, sheltering as best they could, this was no consolation. But as they braced themselves for an agonising winter and for years of rebuilding, it holds the hope that some day a brighter spring will come.

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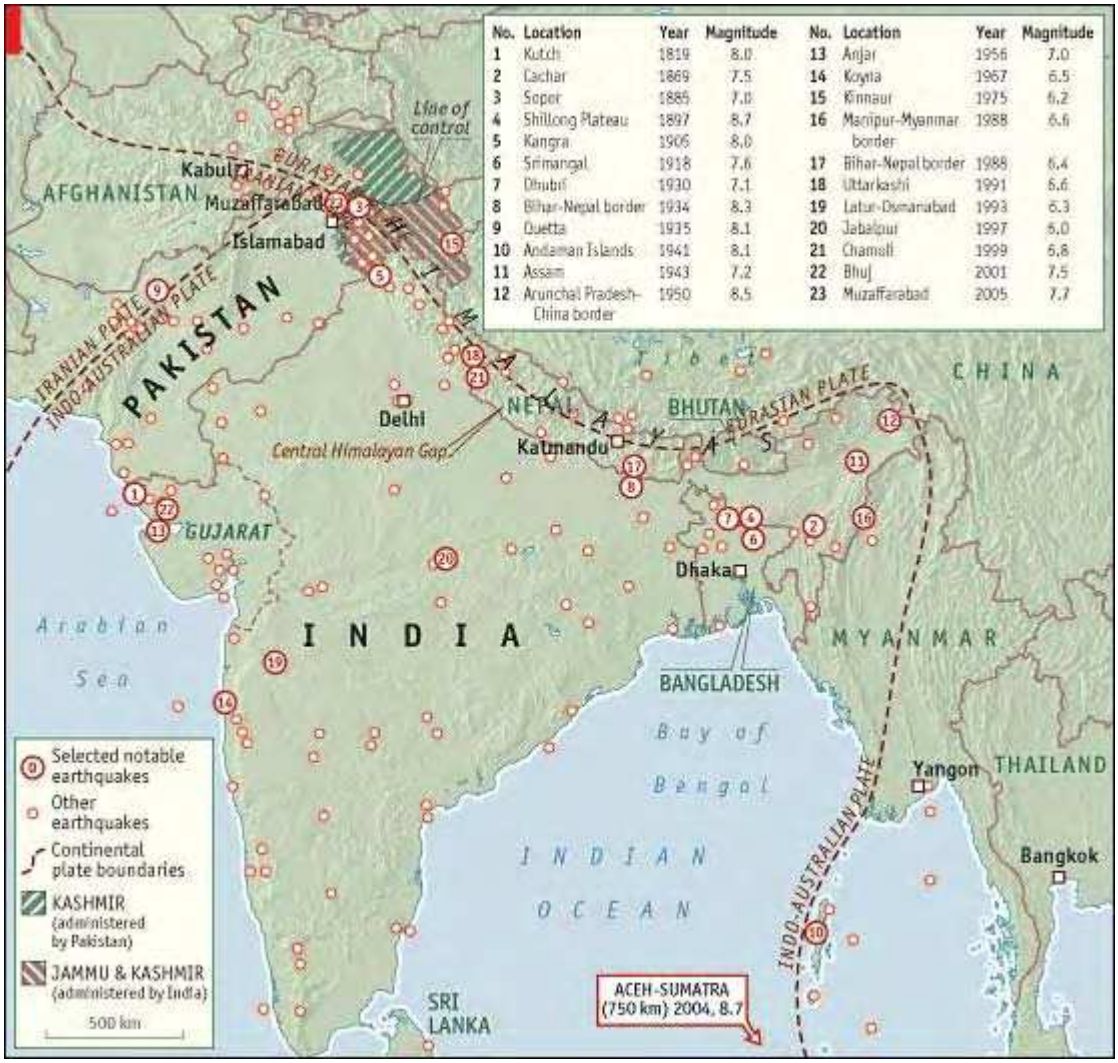
Economist.com SCIENCE & TECHNOLOGY

Earthquake science

Preparing for the unknowable

Oct 13th 2005
From The Economist print edition



Why the Kashmir earthquake happened and what might be done

Get article background

PAKISTAN'S earthquake measured 7.6 on a scale known as the moment magnitude. This measure, a successor to Richter, allows seismologists to compare the energy released by different earthquakes. At each step of the scale, about 32 times more energy is released than at the previous step. It has no upper limit, but the largest recorded earthquake was in southern Chile in 1960 and measured 9.5.

Earthquakes happen mostly where the earth's tectonic plates collide. In Pakistan, quake activity is mainly concentrated in the northern and western sections of the country, along the boundary of the Indian, Iranian and Eurasian plates. The Indian plate is moving north at about 5cm a year, resulting in a force on the southern edge of the Tibetan plateau—the force that generates the Himalayas. As a result, earthquakes occur along the Himalayas all the way to Myanmar. (The movement of the Indian plate also caused the devastating Sumatra-Andaman earthquake and tsunami late last year.)

In recent years, Pakistan has not suffered as greatly from earthquakes as its neighbours in the Himalayas, Afghanistan, Nepal, China and India. Its biggest earthquake in living memory occurred in Quetta in 1935, with 30,000 deaths. Nevertheless, Kashmir is seismically active on both sides of the border, with many regular, though less damaging, quakes. In 2002 in the Gilgit-Astore region, 100km (63 miles) north of Muzaffarabad, large earthquakes made about 16,000 people homeless.

Across the Himalayas there is what seismologists call a “slip deficit”—a lack of earthquakes to release the stress that is known to be accumulating. The Kashmir quake was in just such a region, where a great earthquake was overdue. Nevertheless, Roger Bilham, of the University of Colorado, says it is doubtful that the Kashmir quake released more than one tenth of the cumulative energy stored there. Furthermore, in the past half-century the Himalayan region has seen fewer powerful earthquakes than might be predicted from historical records. The most notable area of concern is the central Himalayan Gap, a 600km-long central arc of the Himalayas. Mr Bilham believes this area has the potential to generate several earthquakes of magnitude 8 or more, and is the most vulnerable (in terms of potential loss of life and damage) of the regions that could produce a great earthquake. The whole of Nepal is also a worry.

The Kashmir quake may be the worst recorded in the Indian subcontinent. Its deadliness was linked, among other things, to the weakness of buildings, the depth of the quake, the density of population, the fault and soil types, and the intensity of the shaking. The Bhuj earthquake, only 100km from the border of Pakistan, was of similar magnitude but killed 18,500.

Because of population growth and density in the Himalayas, hundreds of thousands may be at risk—particularly in India, where the government and the United Nations Development Programme have identified 38 cities with more than half a million people located in the most seismically active regions. A way has to be found to reduce the deadliness of quakes in the most vulnerable areas.

Yet earthquakes cannot be predicted accurately enough to know when people should be evacuated. It is all the harder in the Himalayan region, with hidden underground faults that are poorly monitored by seismic instruments. That leaves two options, other than fatalism: to put up better buildings, and to improve planning for responding to disasters.

Progress is slow. Key buildings in need of better earthquake-proofing have been identified in Delhi, and work is under way. Similar plans elsewhere have come too late to help the hospitals in Indian Kashmir. Though it is impossible to make buildings completely resistant to earthquakes, they can be made much safer. In both India and Pakistan, building codes exist; in both countries, they have been poorly enforced, with masses of unprotected housing stock in areas of great danger.

In India, to build more suitable housing would add only 2-4% to construction costs. But in the poorest regions, such as Kashmir, most houses are built of local materials by the people who then live in them. In fact, in India, 80% of housing is owner-built. Architects and engineers, who might improve building and design, are in short supply. It is lack of knowledge and skills that is the main problem, rather than the cost of the work.

Greater scientific knowledge about the region's earthquakes and faults would much improve understanding of which areas are most at risk. For this reason, Mr Bilham wants to gather

evidence as quickly as he can before rain or earth-slips obliterate it. Astonishingly, he has been refused a visa.

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The Federal Reserve

After Alan

Oct 13th 2005 | WASHINGTON, DC
From The Economist print edition

Alan Greenspan has dominated American economic policy for two decades. Who can fill his shoes and what will happen to the Federal Reserve once he has gone?

THE contrast could not be starker. George Bush's decision to nominate Harriet Miers, his White House lawyer, to the Supreme Court has spawned a furore. Meanwhile, the White House is about to decide on another nomination that may affect the country even more but which has attracted little attention: a successor to Alan Greenspan, the man who has run the Federal Reserve Board for the past 18 years and who is often called the second most powerful person in the country.

Only 13 men have headed America's central bank since its creation in 1913 and only five in the past half-century. Most have had a reach that extended well beyond setting monetary policy. In the 1970s, Arthur Burns was an architect of Richard Nixon's wage-and-price controls. Paul Volcker, Mr Greenspan's predecessor, led the response to the 1980s debt crisis.

But Mr Greenspan's influence extends further than any of his predecessors, thanks to his longevity in the job, a remarkable economic record and a willingness to become involved in virtually any area of public policy. Since he became Fed chairman in 1987, America has seen only two mild recessions (compared with four deeper ones in the previous 18 years) and he has steered the financial system through the 1987 stockmarket crash (which took place two months after he took over), the savings-and-loan debacle, the emerging market collapse in 1997 and the terrorist attacks in 2001.

That record helps explain his near god-like status. At the Jackson Hole gathering of central bankers in August, two academics gushed that “he has a legitimate claim to being the greatest central banker who ever lived.” Politicians seek his benediction on issues as diverse as pensions

reform and China's currency policy. A fawning biography by Bob Woodward is simply called “Maestro” (2000). In the 2000 presidential campaign, John McCain quipped that were Mr Greenspan to die, he would “prop him up and put a pair of dark glasses on him and keep him as long as we could.”

Many in the White House feel the same way, but Mr Greenspan has made it increasingly clear that he has no wish to stay on as a caretaker after his term runs out at the end of January. The process of searching for a successor began more than two years ago. Strangely, Mr Bush claims he has still not seen a list of potential candidates. If true, that would be troubling. Any successor must be confirmed by the Senate. Much of the next three months will be taken up with holidays.

It is more plausible that Mr Bush has still not settled on a candidate. In 1987, Mr Greenspan was top of everyone's list as a potential successor to Paul Volcker. (Bond markets had their biggest one-day drop in five years on the day his nomination was announced, but that was because financiers feared that Mr Greenspan, then something of a Republican hack, might be a more political chairman.) This time, there is no clear heir apparent.

Last week, Mr Bush suggested that the nominee needed to be someone who could “do the job” and who would be “independent” from politics. In the light of his choice of Ms Miers, no one is quite sure what this means. White House officials have made clear privately that they consider none of the most-widely touted candidates to be ideal. So the job could yet go to an outsider—though an unknown candidate might spook Wall Street.

The favourite at the moment is **Ben Bernanke,** a respected monetary economist, former Fed governor and currently chairman of Mr Bush's Council of Economic Advisers (CEA). Online betters at Tradesports.com reckon he has a 38% chance of getting the job (see odds above with pictures of the candidates). He is the best monetary economist of any of the candidates and was an unusually high-profile Fed governor. But he has little policymaking experience and has only just moved to the White House.

Another option is **Martin Feldstein**, a highly regarded macroeconomist who chaired Ronald Reagan's CEA. His academic credentials are impeccable, though they are focused more on fiscal than monetary policy. But he has not been closely involved in policymaking for two decades and he annoyed many supply-side conservatives by decrying Mr Reagan's deficits during the 1980s. That suggests independence, though this White House loathes disloyalty. And he might face a tough grilling in Congress because he is on the board of AIG, a troubled insurance giant.

Two obvious Bush loyalists are **Glenn Hubbard** and **Larry Lindsey**. Mr Hubbard was Mr Bush's first CEA chairman and is another academic who has focused on fiscal policy. Though his academic record is less stellar than that of Messrs Bernanke and Feldstein, he was a huge success at the CEA and gets on famously with the president. Mr Lindsey was a Fed governor in the 1990s and Mr

Bush's chief economic adviser in the 2000 campaign. He was, however, fired as an adviser in 2002 partly for announcing publicly that the cost of the Iraq war could top $200 billion (an honest indiscretion).

Another name that has gained credence in the wake of Mr Bush's comments about independence is **Don Kohn**, a long-time Fed staffer who was appointed as a governor by Mr Bush in 2002. Mr Kohn is less of an academic than his rivals but he has more practical experience, is more independent of party politics and is said to be the candidate favoured by Mr Greenspan (which counts for a lot, especially with Dick Cheney). Against him, Mr Kohn has few political relationships outside the Fed and is relatively unknown. **Roger Ferguson**, the vice-chairman, is also mentioned as a possible in-house pick.

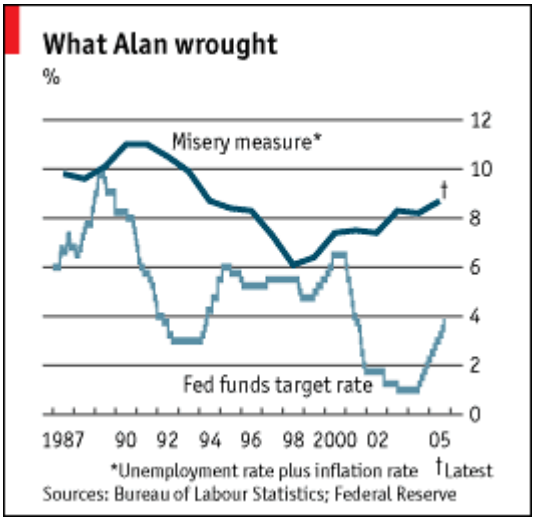
All of these candidates easily pass the competence test. But none fits the mould of Messrs Volcker and Greenspan. Neither of those men was a stellar academic, but they had both been steeped in Washington policy-making and practical economic analysis for years before their appointment. Mr Volcker held top positions at the Treasury and was president of the New York Fed. Mr Greenspan had chaired the CEA in the Ford administration, and headed President Reagan's bipartisan Social Security reform commission as well as run his own private forecasting firm.

Arguably, the main thing Mr Bush should focus on is who would be best prepared to handle a crisis. Given the size of America's imbalances—the current-account deficit, the overvalued housing market, the overextended consumer—an upset is possible. Mr Volcker has said there is a 75% chance of a crisis in the next few years. Even Mr Greenspan worries that people are becoming too sanguine about risk.

Worse, the Bush administration is bereft of economic heavyweights to deal with any meltdown. There are some energetic mid-level officials, but the top brass, such as John Snow, the treasury secretary, are decidedly sub-par. Mr Greenspan has long been the sole grown-up—a “security blanket” as one insider puts it.

Crises aside, directing monetary policy remains the core job. The Fed chairman runs the rate-setting Federal Open Market Committee (FOMC), which brings together the Fed governors in Washington, DC, with presidents of the regional federal reserve banks. Policy making is easier now than when Mr Greenspan took over. Inflation is low, the central bank's credibility as an inflation-fighter is cemented and the members of the FOMC are determined to keep it that way. As one insider puts it, the dangers of a lousy driver are lower when a car runs more or less automatically.

That does not mean there will be no tricky decisions: inflation expectations are rising, albeit from a low base, and nobody is sure how far interest rates need to rise. The next chairman may have to be relatively hawkish early on, to bolster his inflation-quashing credentials.



What about the Fed itself? It has changed a lot over the past two decades. In the late 1980s, there was scant public communication. Fed watchers had to infer whether the central bankers had loosened or tightened policy. Mr Greenspan was famous for “mumbling with great incoherence”. Now the central bank not only announces any changes in the federal funds rate, but also guides the markets. The FOMC minutes are published (with a three-week lag) and Mr Greenspan steers traders through his speeches and testimonies (though he retains a penchant for circumlocutory phrases).

Nonetheless, American monetary policy strategy is less transparent and more personalised than in many other modern economies. America's central bankers have no explicit inflation target. Mr Greenspan is famously sceptical of relying too much on academic models.

Instead the “Greenspan standard” is based around risk management. The central bank, he argues, should focus not simply on the most likely risks to the economy, but also on those dangers, such as deflation in 2003, whose odds may be low but whose costs would be high. Alan Blinder and Ricardo Reis of Princeton University recently characterised this approach as “minimal strategic constraints...maximal tactical flexibility...and not much in the way of explanation”.

Though this broad strategy is likely to be emulated by any successor, there may be tinkering at the margins. Mr Lindsey, for instance, is keen for the central bank to pay closer attention to asset prices. Mr Bernanke is an outspoken advocate of developing a clear inflation target—though Messrs Kohn and Lindsey are not.

Changes in style may be apparent sooner. The Fed chairman is usually a dominant figure. Mr Burns was deemed tyrannical, Mr Volcker imperious. Mr Greenspan has a more collegial approach. Ted Truman, a long-time Fed staffer now at the Institute for International Economics, remembers staff, governors and regional presidents going to dinners at the house of Mr Greenspan's then girlfriend (now wife). Some early critics said he was too democratic and tolerant of dissent.

Although Mr Greenspan's approach remains low key, he now dominates monetary policy decisions, invariably shaping the consensus towards an outcome he prefers. In the 65 FOMC meetings since 1998 there have been only 15 dissenting votes. And although all participants get a chance to air their views, the meetings are hardly a free-flowing discussion.

The next chairman will have less sway over the regional bank presidents. Some of the candidates from academia might even want more debate. Mike Prell, another former senior staffer, says academics who have come to the Fed have often found the FOMC's formality “a strange way to do business”. It is hard to imagine the plain-spoken Mr Bernanke following Mr Greenspan's circumlocutions.

The political world may actually feel Mr Greenspan's absence most outside monetary policy. Many accuse him of partisanship. His support for Mr Bush's 2001 tax cuts, in particular, infuriated Democrats. Some fret that the more central bankers pronounce on fiscal policy, the more Congress may be tempted to meddle with monetary policy. There is no evidence of this yet, but Messrs Hubbard, Lindsey, Bernanke and Feldstein, because of their Republican connections, could all become lightning rods for partisan bickering if they enter broader policy debates.

Mr Greenspan's successor is likely to have a lower profile at first. Changes to the conduct of monetary policy will be incremental; there will be less opining on unrelated economic issues. But no Fed chairman ever stays below the parapet for long. With the possible exception of William Miller, whose brief tenure in 1978-79 was notable for his attempts to ban smoking at the board, America's central bankers have all made their weight felt across the political sphere. The 14th chairman of the Federal Reserve Board will do the same.

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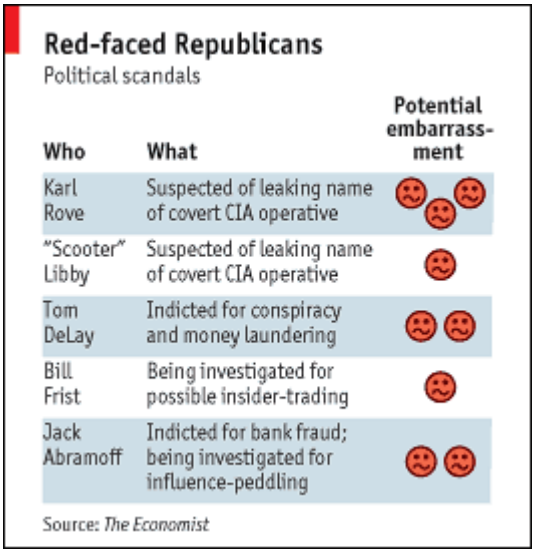
Republican scandals

Mud, inglorious mud

Oct 13th 2005 | WASHINGTON, DC
From The Economist print edition

A short primer on who is alleged to have done what and whether it matters

CASUAL observers of the American political scene will be aware that the Republican Party is having ethical problems. Like an elephant in a minefield, every step it takes sets off an explosion and a shower of mud. The trouble is, the details of each individual scandal are often arcane. For your convenience, here is a brief guide to who is being investigated for what.



Start with Karl Rove, the biggest beast in the investigators' crosshairs. Mr Rove, the “evil genius” behind George Bush's consistent electoral success, is suspected of leaking to journalists the name of a covert CIA operative called Valerie Plame. The law forbids this for the obvious reason that, if the unmasked agent is a mole in a Saudi terror cell, he will probably have his head cut off. Ms Plame had a desk job in Virginia, so she was not in danger, but that may not get Mr Rove off the hook.

Why would Mr Rove leak a covert agent's name to the media? The theory is that he wanted to discredit Ms Plame's husband, a former ambassador to Gabon called Joseph Wilson, who had accused Mr Bush of twisting intelligence to justify war in Iraq. Mr Wilson had been sent to Niger to see if Saddam Hussein had tried to buy uranium there. He concluded that he had not. Mr Bush's state-of-the-union address in January 2003 suggested that he had. Mr Wilson effectively called the president a liar in the *New York Times* on July 6th 2003. His wife's cover was blown in a column by Robert Novak on July 14th, which said she had got Mr Wilson the job.

A special prosecutor, Patrick Fitzgerald, is investigating. Mr Rove denies leaking Ms Plame's name, and allegedly gave Mr Bush assurances to that effect. But Matthew Cooper, a reporter for *Time* magazine, has reportedly testified that Mr Rove told him Mr Wilson's wife worked for the CIA, without revealing her name.

One explanation of Mr Rove's alleged behaviour is that he did not know that Ms Plame was a covert, as opposed to common-or-garden, CIA operative, and therefore did not know he was committing a crime. But this is speculation. The special prosecutor is expected to wind up his investigation by October 28th, when the current grand jury's term expires. If he indicts Mr Rove—expected to testify this week—it could be catastrophic for Mr Bush.

Another smaller target in the same mess is Lewis “Scooter” Libby, chief of staff to Dick Cheney. Another reporter, Judith Miller of the *New York Times*, served 85 days in jail for refusing to testify about her conversations about Ms Plame with Mr Libby and other officials. (She changed her mind after her sources urged her to testify, and was released last month.) Like Mr Rove, Mr Libby

admits to discussing Ms Plame with reporters, but denies naming her or revealing that she was a covert agent. Anything that affected Mr Cheney would also hurt Mr Bush.

The next scandal involves Tom DeLay, the suspended majority leader of the House of Representatives. He was indicted late last month for conspiring to violate Texan campaign-finance laws in 2002. Ronnie Earle, a Democratic Texas district attorney, alleges that a political action committee controlled by Mr DeLay funnelled corporate donations to Republican candidates in Texas by laundering the money through accounts belonging to an arm of the national Republican Party. This made it look as if the money was coming from individual donors (which would be legal in Texas), rather than from corporations (which would not).

Mr DeLay denies any wrongdoing and accuses his tormentor of being a dishonest partisan. His lawyers said the crime for which Mr DeLay was first indicted was not a crime at the time he was alleged to have committed it. Mr Earle promptly found “new evidence” and announced two more indictments, for conspiracy and money-laundering. Mr DeLay's lawyers have now accused Mr Earle of acting improperly in the way he cajoled grand juries into issuing indictments. Mr Earle denies it.

The charges against Mr DeLay will be hard to prove, and the case could drag on well into next year. Although Mr DeLay has been obliged to step aside as House majority leader, at least temporarily, the fuss has not stopped him from doing what he does best, which is to coax and browbeat Republicans to support laws they don't necessarily like. Only last week, he hammered a controversial energy bill through the House in a 212-210 vote.

The Senate majority leader, Bill Frist, is being investigated for alleged insider trading. Mr Frist used to own a lot of stock in HCA, a hospital chain founded by his family. As a senator, he figured that putting the shares in a blind trust would shield him from accusations of conflict of interest when the Senate pondered health-care bills. But as a presidential aspirant, he decided it would be wise to sell them.

He did so shortly before the firm announced worse-than-expected earnings, causing the share price to tumble. He denies having received inside information, and has reportedly produced e-mails showing that he discussed the sale months before it was executed. The *Washington Post* claims he has been subpoenaed to turn over his records. But on current evidence, Mr Frist is likely to be exonerated.

Another scandal involves a former lobbyist called Jack Abramoff. Though not part of the Republican power structure, he has been chummy with many of its members, including Mr DeLay. Mr Abramoff has been indicted in Florida for alleged bank fraud, and is under investigation in connection with millions of dollars he and his associates received in lobbying fees from casino-owning Indian tribes. His links with legislators are also under scrutiny—he organised a lot of golf trips.

The problem for Mr Bush is that scandals tend to sprawl. For instance, on October 5th, David Safavian, the former head of procurement policy in the White House, was indicted for allegedly lying and obstructing the probe into Mr Abramoff's affairs. Rumour has it that prosecutors are trying to get Mr Safavian to testify against bigger fish. Meanwhile, journalists have been harrying Mr DeLay's replacement in the House, Roy Blunt, about money that allegedly flowed between campaign groups controlled by Mr DeLay, Mr Blunt and his son, Matt, the governor of Missouri.

Taken separately, none of these scandals would derail the Republican agenda. But together, they create a cumulative impression of sleaze that could cost the party votes both in 2006 and 2008. That is the main problem with mud; it sticks.

Religion and the law

A brewing storm

Oct 13th 2005 | COLORADO CITY
From The Economist print edition

An increasingly nasty battle between a strict polygamous sect and the state

THIS small Arizona town on the Utah border looks idyllic enough. Mountains loom behind it, tomatoes grow wild, and children trot past on pet ponies. But when Gary Engels, the Mohave County state investigator, does his morning rounds in Colorado City, drivers try to run him down, women in long skirts call him a bastard and small boys spit at him. “They hate me,” sighs the state investigator, dodging another truck.

Such hostility conveys the growing tension between the Fundamentalist Church of Jesus Christ of Latter Day Saints (FLDS), America's largest independent polygamist group, and outsiders. The 10,000-member sect dominates Colorado City and the neighbouring town of Hildale. In June, as a result of Mr Engels's snooping, the leader of FLDS, Warren Jeffs, was indicted on two charges to do with organising child-bride marriages; he fled immediately. Eight other members, who turned themselves in, face similar charges, which they deny.

The FLDS used to be a rebel offshoot of the Mormon church. Its members believe they are the chosen people, Mr Jeffs is their prophet and everyone else is damned. Members also openly practise polygamy. This is illegal but there are no penalties cited in the Arizona constitution.

The current dispute has to do with two different sets of former FLDS members. The first are the “lost boys”, disillusioned rebellious teenagers who have been ousted from the FLDS and dumped in towns such as Hurricane, Utah. They are the source of many of the accusations against Mr Jeffs. Lawyers in Salt Lake City, working on behalf of the young men, claim that Mr Jeffs forced families to kick them out and cite both emotional and physical abuse.

The second, equally embittered, group are older excommunicated property owners. Rather than moving away and “repenting from afar,” as FLDS leaders insist they should, these refuseniks have stuck around to reclaim their homes. All the homes and chattels of FLDS members belong to a United Effort Plan which holds the property in trust. Now state officials are trying to let former members reclaim “their” homes.

Meanwhile, another battle is raging in the Colorado City Unified School District. Teachers claim school funds were pilfered by FLDS leaders. The state has petitioned to put the district into receivership; the district is arguing back. A special state Board of Education meeting on October 20th will decide whether the FLDS can retain its financial control. And to put even more pressure on the city, Arizona's attorney-general has just announced a federal civil-rights review of the police department.

All this is making the FLDS fight for its life, says Benjamin Bistline, a local historian. Its members fear a repeat of the mass police raid of July 1953, where scores of men were arrested and children were separated from their parents.

Colorado City and Hildale have become very tense towns. FLDS homes are distinguished by huge

fences and “No Trespassing” signs. Members separate themselves from non-members by their clothes: the men in long-sleeved shirts, the women in long dresses. Outsiders have never been particularly welcome anyway; Colorado City boasts no hotel, bar or café, just a post office, a corner shop and a tiny milk store.

Mr Engels is not the only harassed local. The teacher who revealed the alleged misuse of school funds wound up with his windows smashed. A couple who spoke to a television station last year had rubbish thrown on their driveway. Ousted children quiver before journalists lest their parents, who are still members, are punished. “This is like communism,” says Guy Johnson, a construction worker in Hurricane who left the group 20 years ago. “You leave penniless and alone because even your family turn on you.”

Even so, the exiles are fighting back. Enough lost boys returned over the summer for the North Mohave Community College's Colorado City campus to start a general education course designed to equip the ousted teenagers for the modern world. Most have been to a private school that teaches Mr Jeffs's beliefs.

The former homeowners meet fortnightly to work out their strategy. Andrew Chatwin was thrown out 15 years ago after confronting Mr Jeffs. His Mormon wife, Michelle, and their four small children stay at the cramped home of Uncle Marvin, a former FLDS member with 32 children from his four wives. Their handsome grey stucco property lies uninhabited, but monitored by church members a block away. “I won't stop till I get the deed,” Mr Chatwin says.

Some form of showdown looks inevitable. Mr Bistline reckons half the group will leave once Mr Jeffs, thought to be in either Mexico or Texas, is caught. The exiles claim all they want is a return to the freer life they enjoyed before Mr Jeffs took control. At the back of Uncle Marvin's property, a can of fly spray lies in the children's playhouse. Neighbours threw it, the children say. Mr Chatwin refuses to budge. “I was born here, and we won't leave our family or roots.”

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The Cheyenne river Indian reservation

At least the buffalo are thriving

Oct 13th 2005 | RED SCAFFOLD
From The Economist print edition

An old way to help the poorest county in America

THE village of Red Scaffold in Ziebach County, South Dakota, can be reached only by negotiating the deep furrows of an unpaved, gravel road. Cars, built for a world of asphalt and white lines, do not have an easy life here. The corners of many housing plots serve as a kind of knacker's yard for lamed vehicles.

The county, one of two on the Cheyenne river Indian reservation, has a poverty rate of 49.1%, the highest of any of the 3,141 “counties or county equivalents” in the United States. The reservation covers 2.8m acres of rolling prairie under an expansive sky, yet the homes can be as overcrowded as any city housing project. Agriculture is still the mainstay of the economy. The skyline of Dupree (population 450) is dominated by a grain elevator.

But Indians own only about half of the reservation's land. And those acres are themselves only one fragment of the Great Sioux reservation, which in the 19th century spanned both North and South Dakota. In 1877, the Sioux were deprived of the gold-rich Black Hills and in 1889, the remainder of the reservation was dismembered into six parts. The Cheyenne river reservation, one of those six fragments, was destined to become smaller still. It lost more than 100,000 acres beneath the waters of Lake Oahe, a reservoir created in 1962 by the Army Corps of Engineers.

In popular opinion, the prosperity of native Americans no longer depends on either land or livestock. Casinos are meant to be the “new buffalo”. According to a 2002 study by William Evans and Julie Topoleski of the University of Maryland, employment rises by an average of 26% in counties that open a casino. But the “new buffalo” on the Cheyenne River reservation are, well, buffalo.

The tribe has won recognition from Harvard University for its project to restore the prairie grasslands on which the animals thrive. Its herd of about 2,000 is admired by conservationists and tourists alike. Should they want to take one home with them, visitors can also pay $3,000 for the right to hunt a bull (and another $300 to have it skinned and quartered).

All very traditional. But what about the common complaint that reservations preserve the cultural heritage of Native Americans only at the cost of sequestering them in what are, in effect, rural ghettos?

Scholars at Harvard's Project on American Indian Economic Development argue that some of the most successful tribes are actually the most culturally conservative. Tribes that have preserved their native tongue and circumscribed their membership also run better timber ventures and housing projects, says Miriam Jorgensen in a study published in 2000. Tribal languages and “blood quantum” rules—which specify how closely related to the tribe a member must be—serve as useful proxies for the kind of social cohesion necessary for development. Reservations are not ghettos from which the poor must escape, but small, land-locked nations, which must take charge of their own affairs and find a niche in the wider economy. And buffalo tourism is not a bad way to begin.

At the 70th annual pow-wow in Red Scaffold, the drum sets a beat for young dancers, in their feathered costumes, and for older ones, their star quilts pulled round their shoulders. The pow-wow is one place where kith and kin can get reacquainted, strengthening the “social glue” Ms Jorgensen deems so crucial. But the drum also offers more immediate relief. “If you're whingeing and whining too much,” the master of ceremonies tells his audience, “we won't be able to hear you.”

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Abortion politics in California

Hard decisions to make

Oct 13th 2005 | LOS ANGELES
From The Economist print edition

Too many teens get pregnant. Would a controversial initiative help?

Get article background

“I WOULDN'T want to have someone take my daughter to a hospital for an abortion or something and not tell me. I would kill him if they do that.” So much for Arnold Schwarzenegger's typically expressive support for Proposition 73, a constitutional amendment on the November 8th ballot requiring doctors to give parents 48 hours' notice before carrying out an abortion on a girl under 18.

Will the voters agree with the governor? His own status—erstwhile hedonist turned responsible father of two teenage girls and two pre-teen boys—reflects his state's mixed feelings about sexual politics. California is one of the most sexually liberated states in the nation. It also boasts the fifth-worst rate for teenage abortions and the seventh for teenage pregnancies. In 2000, some 116,000 teenagers in California became pregnant, and almost 44,000 of them chose to have an abortion—including 1,620 under the age of 15. A recent Field Poll showed 45% of respondents in favour of the amendment, 45% against and 10% undecided.

The proposition's advocates are careful to argue that supporting parental notification is not the same as opposing abortion full stop. Mr Schwarzenegger is a “pro-choice Republican” and the proposition would allow a minor to petition a court to allow her an abortion without notifying a parent. The real point, they say, is that a 17-year-old girl “can't get an aspirin from the school nurse, get a flu shot, or have a tooth pulled without a parent knowing”, but a 13-year-old can have a surgical or chemical abortion without her parents' knowledge. And since a majority of the prospective fathers are over 21, the current system in effect condones statutory rape.

Opponents, including the California Nurses Association and Planned Parenthood, are unconvinced. As an editorial in the *Los Angeles Times* argued: “It's nice to think that all girls feel comfortable talking to their parents about sex, birth control and abortion. Nice, but absurd.” Equally absurd, add other opponents, is the notion that a pregnant teenager from an abusive family will have the gumption to go to court—rather than to some backstreet operator—to seek her abortion. And they suspect the proposition is the start of an effort to ban all abortions: instead of speaking of a fetus, the proposition defines abortion as causing the “death of the unborn child”.

Just how parental notification would affect the rate of teen pregnancies and abortions is an open question. Some 34 states require some parental involvement in a minor's decision to end a pregnancy, but there is no hard-and-fast correlation with the number of abortions. For example, New Mexico and New Hampshire require no parental notification, but according to the Alan Guttmacher Institute, which studies reproductive health, they ranked 18th and 25th in the rate of teen abortions in 2000. By contrast, Wyoming and Florida, which do have notification laws, ranked 14th and 7th. And even if notification laws deter abortions, they do not seem to deter teen pregnancies: Texas, for example, is ranked 26th in abortions for girls aged 15-19 but fifth in pregnancies for that age group.

This last statistic matters for California, where the main problem is teens getting pregnant in the first place. Roughly a quarter of California's 14-year-olds and three-fifths of its 17-year-olds have had sex. True, according to the Public Policy Institute of California, birth rates fell from 73 for every 1,000 15-19-year-olds in 1991 to just 44 in 2001. But California's teenage girls become mothers at between four and 12 times the rate of their peers in France, Spain, Italy, the Netherlands and Japan; the figures for blacks and Latinas in the state are particularly appalling. Whatever your views on abortion, these statistics add up to an awful lot of heartache.

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The mid-west

The nightmare continues

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From The Economist print edition

Katrina and Rita are still hurting those at the other end of the Mississippi

AFP

Everything is bigger on the Mississippi

FARMERS in the mid-west are having a rotten year. First, a drought shrunk corn ears and hurt alfalfa, though a few droplets of August rain helped salvage soyabeans. Then came the hurricanes. No sooner were New Orleans's docks back up after Katrina than Rita tore through the Gulf, battering more barges and closing coastal waterways again.

Ports across the region are limping back to life, but slowly. The Port of New Orleans, one of America's busiest, is still operating at about 30% of its normal capacity, as measured by ship arrivals. The port at Lake Charles, a Louisiana town that is America's biggest export centre for bagged rice, finally got off generator power last week. Wheat has been slow getting out of Beaumont, a Texas port hard-hit by Rita.

Upriver, the problem is a lack of barges, which has caused transport costs to soar. Barges are simply not available north of St Louis, says Clarence Grant of Carroll Service Company, a northern Illinois agricultural co-operative. There, prices for soyabeans have dropped about $1.80, or 27%, a bushel and corn about 70 cents (33%) a bushel since early August. “I've been doing this 34 years and I've never seen it like this,” says Mr Grant.

The awful weather has exposed the other infrastructure problems plaguing the Mississippi. America relies on its waterways to move everything from oil and coal to chemicals and salt. Some 60% of all grain exports go down the Mississippi. But the drought, now several years old, has caused barges to scrape the bottom. Missouri's two senators wrote to George Bush last month to request the Army Corps of Engineers, which handles these things, to “release supplemental flows” from the Missouri river into the Mississippi. They said that barges were 20% lighter and travelling 25% slower than usual.

There is a third, even thornier matter: the run-down locks on the upper Mississippi. Many of these, between Minnesota and St Louis, date back to FDR's New Deal. They are too short for today's massive tows, which consist of about 15 barges bound together (30 on the lock-less lower Mississippi). The barges must be broken up to get through. This costs time and money. Sometimes the locks break.

In July, before Katrina struck, the House of Representatives voted overwhelmingly (406-14) to authorise $1.8 billion to be spent to create seven new locks, which will be double the size of the old ones. Another $235m would upgrade more upstream locks. More still would be spent on river conservation. The Water Resources Development Act is now in the Senate. Its sponsor, Kit Bond, the senior senator from Missouri, says that more items may be added in response to Katrina.

All told, this would be one of America's most expensive river projects. Greens say it is a boondoggle that would wrongly prop up a dying industry. Water quality would suffer, wildlife would lose more habitat and underwater plants would be smothered, says Mark Beorkrem of the Illinois Stewardship Alliance—all for saving a few dozen hours on a trip that takes a couple of weeks. And agricultural shipping down the Mississippi has been falling anyway: volume through the Port of South Louisiana fell by one-fifth between 1999 and 2004.

Meanwhile, in the wake of Katrina, many mid-westerners are worrying once again about the mighty river that sustains them. Even in the current drought, the waters that are now squeezed by sandbars could spill over their banks next spring. A certain degree of flooding is expected; but many locals remember the Great Flood of 1993, when people who lived as much as ten miles from the river, and as far apart as Fargo and St Louis, found it flowing through their kitchens. The Corps of Engineers recently announced that the 11 miles of flood wall protecting St Louis are still damaged. They may not be able to withstand another flood as high as that of 1993.

And for the really spooked there is an even bigger worry. During the winter of 1811-12 the New Madrid fault zone in southern Missouri experienced a series of earthquakes more powerful than any in California. The shock made church bells ring in Virginia and Boston, and the Mississippi river briefly ran backwards. Back then, of course, the region was barely populated (by Europeans, at any rate). Today a tremor of similar magnitude would devastate St Louis, Memphis and everything in between.

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Lexington

Just good friends

Oct 13th 2005
From The Economist print edition

Cronyism is as American as apple pie. But this time George Bush has gone too far

Get article background

THERE are few things quite as hypocritical as American politicians hurling accusations of cronyism. The Democrats are lambasting George Bush about his weakness for promoting people such as Michael Brown, the horseman turned emergency-agency chief. But does anybody seriously believe that a Democratic president wouldn't appoint cronies of his or her own? And it works the other way as well. The White House is currently defending Harriet Miers as “exceptionally well-suited” for a job on the Supreme Court. But does anybody seriously believe that the Republicans wouldn't have been up in arms if Bill Clinton had tried to put his personal lawyer on the Supreme Court?

All countries have their cronies. That much-cited model of moral rectitude, Tony Blair, is so surrounded by them that they are called “Tony's cronies” (he made his old roommate, Charlie Falconer, Lord Chancellor). Edith Cresson, a European commissioner, appointed her dentist to an advisory position. But you expect that sort of thing in Brussels. America's problem is the contrast between high-minded idealism and low practice.

America regards itself as the world's purest meritocracy—a country based on talent, not patronage and toadyism. A quick glance at history shows this is rubbish. Most presidents surround themselves with a regional mafia: look at Carter's Georgians or Reagan's Californians or Clinton's Arkansans. These mafias produce some rum appointments: Jimmy Carter made his one-time campaign driver, Jody Powell, his press secretary; Bill Clinton made his chum from Miss Marie's kindergarten in Hope, Thomas McLarty, his chief of staff. Scandals are endemic. Harry Truman's Missouri cronies had a weakness for gifts of mink coats and freezers (an issue in the 1952 election). As for the antics of Mr Clinton's Arkansas buddies, the less said the better.

That does not mean every close ally is a “crony”; that term implies incompetence as well as proximity. Condoleezza Rice is no Michael Brown, for example, just as Robert Reich was no Webb Hubbell. All presidents worth their salt bring in heavyweights as well as toadies. Indeed, the trick of running a successful administration—as both FDR and JFK demonstrated—is to balance the competing claims of personal loyalty and individual merit. Mr Bush, as the candidate of the Republican establishment rather than a regional insurrection, brought in plenty of bruisers. Dick Cheney and Donald Rumsfeld are guilty of many things, but being mere creatures of the president is not one of them.

Still, if the presidential branch doesn't run on cronyism alone it can't run without it. A presidential campaign is a huge gamble. Presidents acquire obligations to people who spend years toiling for them in the wilderness. Not all these people will be from the first division. Presidents also form a peculiar bond of trust with people who served in the campaign trenches with them. Once they are in the White House, the only people they meet are supplicants. So they naturally turn to their old buddies for comfort and advice. Presidents need cronies just as cronies need patrons.

From this perspective the real question about Mr Bush's appointment of Ms Miers is not whether it is cronyism, but whether he has stepped over the line that separates business-as-usual from offensive favouritism. A definitive answer to that question may not be clear for years. But the early signs are that he has overstepped, and done so in a clumsy way.

The reason for this is simple: a seat on the Supreme Court is a very different thing from even the most elevated job in the White House. The court is the summit of the third branch of government and its justices serve for life rather than just at the president's pleasure. Mr Bush is not the first president to nominate a close friend to the court—FDR nominated Felix Frankfurter, who turned out to be a good choice, and Johnson nominated Abe Fortas, who resigned from the bench under a cloud—but both were defensible in terms of intellect and experience.

There is little evidence that Ms Miers passes this test. Conservatives such as George Will say she would not have made anybody's list of the top 100 conservative lawyers in the country. The implication is that even if she turns out to be a conservative fellow-traveller (which they doubt) she won't have the intellectual weight to shape the court. As for the White House's feeble defence of her qualifications, it brings to mind the infamous justification for Richard Nixon's nominee, Harold Carswell: “Even if he is mediocre, there are a lot of mediocre judges and people and lawyers. They are entitled to a little representation, aren't they?”

An “obsequious instrument of his pleasure”?

Even more worrying than Ms Miers's intellect is her relationship with the president. As Randy Barnett of Boston University has pointed out, that close bond should be a disqualification for this job. America's system of checks and balances relies on the judiciary being independent from the executive branch. How will Ms Miers be able to rule objectively if she has to deal with a case that reflects badly on Mr Bush?

The one bit of good news in the mess of the Miers nomination is that the Founding Fathers designed the constitution to provide checks on the president's power to advance his cronies. In *Federalist 76* Alexander Hamilton justified the consultative role of the Senate on the grounds that it would discourage a president from appointing people who were “personally allied to him” or who were so insignificant and pliable that they would turn into “obsequious instruments of his pleasure”.

The question now is whether the Senate will play its proper constitutional role. Will the members of the Senate Judiciary Committee put the spotlight where it ought to be—on Ms Miers's

qualifications and her relationship with the president? Or will they just waste time quizzing her on how she will vote on abortion (which she won't answer anyway)? If ever there was a time for the Senate to rise above the culture wars, it is now.

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Brazilian politics

No ecstasy yet

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From The Economist print edition

After the scandals, Lula fights back; but his troubles are still not over

Get article background

IT HAS been four months of agony for the government of Luiz Inácio Lula da Silva. Revelations of wrongdoing by his Workers' Party (PT) and its allies have emerged like instruments of torture from a well-stocked dungeon, mangling Lula's prestige, jeopardising his re-election next year and paralysing Congress. Allegations keep coming (the latest is that Lula's elder brother engaged in influence-peddling), but more slowly and with less painful effect. The worst is probably over for the Lula government, but that does not mean that the best is yet to come.

On September 28th, the government beat off the opposition to elect Aldo Rebelo, a soft-spoken Communist friendly to Lula, as president of Congress's lower house. His main job includes setting the Chamber of Deputies' agenda, but he can also influence expulsion proceedings against politicians implicated in the scandals and, most important from Lula's point of view, he is the man who must decide whether to initiate impeachment proceedings against the president himself.

The PT, which sacked its leaders after admitting making illegal campaign donations to its own congressmen and those of other parties, now looks set to replace them with another set of Lula allies. The party's left wing, enraged by the scandals and disenchanted with the government's orthodox economic policies, tried to take control in party elections on October 9th. But although the final results have yet to come, the leftist candidate, Raul Pont, seems to have lost a tight race to Ricardo Berzoini, a former labour minister who made support for the government his main campaign pitch.

All this is encouraging for Lula, but it amounts to a reprieve rather than a full recovery. The government's command of Congress is shaky. The PT will not soon regain its image as the only clean party in a political mud pit, which had won over millions of voters who did not care for its leftist politics. Lula remains a charismatic leader capable of winning a second term (though most pundits think he now will not). But, among educated Brazilians at least, that charisma no longer awakens expectations of progress and reform. He “lost an historic opportunity to change the country”, says Jefferson Peres, a senator from the anti-Lula left.

The final 15 months of Lula's term may be grim. With 16 congressmen facing expulsion proceedings, including José Dirceu, Lula's former top aide, scandal will continue to produce headlines and distract politicians from the business of governing. Some may lose their parliamentary immunity. Prosecutors and the federal police will then go after them, possibly discovering more about the origins of the illegal campaign money than found so far by congressional investigators. “The crisis will last the rest of the government's term,” predicts Arthur Virgílio, a senator from the opposition Brazilian Social Democracy Party.

Mr Rebelo's election, greased by offers of pork and patronage, suggests that the government has regained some clout in Congress. The PT lost seven of its 91 deputies, mostly to parties of the left, but remains the largest party in the lower house. A frantic round of party-switching before October 1st, the deadline for candidates in next year's elections, left the government with a slim majority, but one composed of opportunists rather than real allies. As the elections approach, some may defect. “The majority is more theoretical than real,” says Rogério Schmitt, an analyst at Tendências, a consultancy.

On the biggest issues, that means gridlock. Everyone agrees that a dose of political reform—penalising congressmen who defect to other parties, for example—could prevent future scandals. But Congress has already missed the deadline for such reforms to take effect in the next election, though it may be extended. Unification of Brazil's 27 separate systems of state sales taxes, a necessity, “is a dream,” says José Carlos Aleluia, opposition leader in the lower house. Forget about big structural changes, such as granting the central bank formal autonomy or loosening the regulatory corset around the labour market. On October 11th, the government killed its own proposal for corporate tax breaks after the opposition made it too generous.

Yet the rest of Lula's term may not be a total write-off. Fernando Abrucio, a political scientist at Fundação Getulio Vargas, a business school, argues that passing laws is the only way for congressmen to redeem themselves in the eyes of the electorate. They could compile a respectable election-year record by reducing the regulatory burden on small businesses, simplifying the vetting of corporate mergers and streamlining judicial procedures. Some congressmen believe that even tax reform is not an impossibility.

Lula is not counting on a dysfunctional Congress to resurrect his political fortunes. He takes credit for low inflation and expected growth this year of 3½-4% (though other big developing countries' economies are growing faster). In 2004 and 2005, around 3m new jobs will be created in the formal sector. Expanded cash transfers are lifting the living standards of Brazil's 30m poorest citizens. Ports and airports are being upgraded. The opposition's attempt “to turn the political crisis into an economic and social one didn't work,” claims Luiz Dulci, a senior adviser to Lula.

After plummeting, public support for Lula has steadied, with 45% of the electorate approving of his performance as president, against a disapproval rating of 49%. Lula is counting on faster growth and fading interest in the scandals to reverse the trend. But he faces an angry left, a disappointed middle class and an opposition revived by the scent of victory in next year's election. The agony may have begun to abate, but there is no hint yet of ecstasy.

Economist.com WORLD LATIN AMERICA

Brazil's São Francisco river project

The bishop and the saint

Oct 13th 2005 | BRASÍLIA
From The Economist print edition

Troubled plans to divert a river to irrigate a drought-stricken region

THE idea has been around since Brazil was ruled by an emperor in the 19th century, but the current president, Luiz Inácio Lula da Silva, is now determined to put it into practice. The plan is to divert part of the flow of the São Francisco river, a 2,900 kilometre-long (1,800-mile) parenthesis across five states, to the *sertão*, an area fabled for its harsh, dry climate and the toughness of the people who have adapted to it. In its current incarnation, the "transposition" is a 4.5 billion *reais* ($2 billion) project to supply water to towns in four thirsty north-eastern states via two main canals that will feed into a network of rivers and reservoirs. It will change the lives of 12m people without hurting a single Brazilian, declared Ciro Gomes, the minister of national integration.

But the project has always encountered as much opposition as enthusiasm, and now the opponents have found a Gandhi. Last month, Luiz Flávio Cappio, a Catholic bishop from Bahia, began a hunger strike in protest, giving up only when the government agreed to re-open the debate 11 days later. What this means is unclear. The government expects to clear the last legal hurdles to the project within the next few weeks. It will then be up to Lula to decide whether to negotiate, give up or proceed, driving the bishop back to his fast.

The government makes the transposition sound grandiose and innocuous at the same time. Its

bounty will come from diverting just 1.4% of the water deposited by the river into the sea, mainly for household consumption. Extra water will be available for industry and irrigation only when the reservoir behind the Sobradinho dam, which produces much of the region's electricity, is nearly full—about 40% of the time. With a secure supply of new water, beneficiary states will waste less of their existing water by storing it to hedge against drought, losing much of it to evaporation.

Ranged against the project is a coalition of riparian states, pro-poor and environmental activists like the bishop and a battery of dissenting experts. Their objections are many and varied. It drains too much water, they say. Already there are “signs of mortality” where the river joins the sea, claims João Alves Filho, governor of the state of Sergipe. Beneficiary states should perfect management of their own water before importing it from outside the region, critics say. Greedy farmers will grab the water from the poor. The project will benefit far fewer than claimed, and the money could be better spent elsewhere.

The costs of the transposition could rise. The state of Pernambuco, which hosts part of the river but is also a potential beneficiary, is eyeing projects worth an additional 1 billion *reais* in exchange for its backing. Bishop Cappio wonders why water is being exported when 3m people live along the river's course, many of them poor and without plumbing. The transposition “will demand huge resources that could be spent on other projects much closer to the reality of the people,” he lamented in a newspaper interview.

Some objections are weightier than others. Water management, for example, is probably a bigger worry than the size of the diversion. Pedro Brito, the project's co-ordinator, responds that the state of Ceará is “100% ready” to manage the water it receives. It has an independent water utility, which charges for the water it sells in bulk. By the end of next year, all four beneficiary states will have management mechanisms in place. Extra canals and pipelines will spread the water more widely.

Now that the debate has become a national controversy, the government will step up its public-relations offensive. Marco Antônio Tavares Coelho, a prominent opponent, expects the project to fail. Aridity is the natural state of the *sertão*; soaking it would be like removing ice from the North Pole, he says. With the right sort of investment, he reckons, the *sertanejos* can thrive in their parched patch of Brazil. It may take a dictator to change the course of the São Francisco.

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Economist.com WORLD LATIN AMERICA

Peru's election

A shadow abroad

Oct 13th 2005 | LIMA
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Alberto Fujimori plans a comeback

Get article background

Reuters

Real passport, "virtual" candidate

HE HAS lived in Japan for almost five years and, in Peru, faces 22 sets of criminal charges, ranging from embezzlement to murder. But such small nuisances have not halted Alberto Fujimori's plans for a political comeback in the country that he ruled with a heavy hand from 1990-2000. He is proceeding in small steps. He has already registered a political party and obtained a new Peruvian passport. Last week, he announced his candidacy for next April's presidential election, injecting further uncertainty into a contest that was already wide open. The campaign risks descending into legal wrangles.

Mr Fujimori divides Peruvians. Some remember him with gratitude for having crushed the Shining Path guerrillas, stabilised the economy and built schools and clinics in remote Andean towns. Others abhor his destruction of institutions, autocratic rule, media manipulation and the corrupt racketeering of Vladimiro Montesinos, his closest aide. Five years ago, shortly after winning a constitutionally dodgy third term in an equally dodgy election, Mr Fujimori fled to Japan as his regime fell apart.

If his comeback is to make any headway, he must now find a way to avoid landing in prison on his return to Peru. His lawyers say they are working to get the charges against him reduced to more minor ones that do not carry arrest warrants. This will not be easy to achieve. In one case, the former president is charged, along with Mr Montesinos and the then army commander, with knowingly allowing an army death squad to operate. Another case involves 70 bank accounts, frozen in Panama last month, through which prosecutors say Messrs Fujimori and Montesinos and their associates moved up to $600m. His lawyers are also seeking to overturn a congressional ruling banning him from holding public office until 2011.

If none of this works, the former president will run as a "virtual candidate" from Japan, one of his lawyers, Rolando Sousa, says. If elected, he would enjoy immunity from prosecution. While such an outcome may seem far-fetched, it cannot be ruled out. The most recent national opinion poll, by Datum, places Mr Fujimori third in the race with 15%—only three percentage points behind the uninspiring front-runner, Lourdes Flores, a conservative. But Mr Fujimori's main aim may be simply to get his followers elected to Congress. He could then offer their votes to the next government in return for a clear run in 2011 (when he would be 73).

Alejandro Toledo's government has been trying for years to get Mr Fujimori extradited. Now Mr Toledo's own failings—several members of his family and entourage have been accused of petty

corruption—have made some Peruvians forget the bigger moral faults of his predecessor. Mr Fujimori is hoping it stays that way.

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Central America

Stan's deadly blow

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More storms bring forward plans for a joint rapid-reaction force

Reuters

Get article background

Another awful statistic

THE scenes are becoming all too familiar. Deforested hillsides, waterlogged after days of rain, collapse in rivers of mud, burying whole villages. In 1998, it was Honduras that bore the brunt of Hurricane Mitch, a category 5 storm with winds of up to 180 miles per hour (290 kph) that killed some 9,000 people. Last year, Haiti was hit twice, the second time by a tropical storm, Jeanne, which killed an estimated 3,000.

This time it was the turn of the Mayan Indian highlands of Guatemala. Hurricane Stan, later demoted to tropical storm, dumped almost a week of torrential rains on the slopes of the volcanoes that ring Lake Atitlan, a popular tourist destination. Most people were asleep when the mudslide hit at about 3am on October 6th. Two villages, Panabaj and Tzanchaj, were entombed by a mudflow half a mile wide and an estimated 15-20 feet deep. Local leaders called off the futile and risky rescue operations, requesting that the villages be declared mass graves.

Although the official death toll in Guatemala stands at just 652, officials fear the figure could reach 2,000. Out of a population of 11m, some 130,000 people have been made homeless and a further 3m left without electricity, water and other basic services. Crops and livestock have been destroyed, while landslides have damaged nearly 2,500 miles of roads, virtually cutting off the entire western province of San Marcos. There is now a danger of hunger and disease. Next door in Mexico, 42 people were reported dead, with a further 72 in El Salvador and 11 in Nicaragua.

The 2005 Atlantic hurricane season, which runs from early June to late November, is already the second-deadliest on record. Stan was the tenth hurricane this year. The frequency of big natural disasters in the region lends weight to a proposal to create a joint Central American rapid-deployment force to respond to such emergencies, as well as to provide peacekeeping missions and greater regional security. Coincidentally, Donald Rumsfeld, the American defence secretary, hosted a meeting of the region's top defence and national-security ministers in Miami this week to explore the idea. America plans to provide logistical and financial assistance to the unit.

The Bush administration is strongly backing the proposal as part of its aim to get Latin America to deal with its own problems, most of which require a collective response. This has already begun. The region has come a long way since the bloody civil wars of the 1980s, American officials say, pointing to growing commercial integration and the recently signed Central American free-trade pact, CAFTA. Even as Mr Rumsfeld was speaking in Miami, a 58-strong American military team, supported by eight helicopters and planes, was delivering food, water, medical supplies and

communications equipment to the most isolated communities, cut off after mudslides and flood waters washed away roads and bridges.

But critics see the rapid-response unit as an invitation for greater military intervention in tackling the ever-increasing violence of organised armed gangs. “Responding to the gang problem is not, and should not be, a military undertaking,” said the Washington Office on Latin America, a private human-rights group, which is wary of Central America's track record of military abuse.

Nowhere is this legacy more acutely felt than in Guatemala, where the armed forces conducted a brutal scorched-earth campaign against indigenous peasant communities suspected of harbouring leftist guerrillas in the 1980s. Geographically isolated and culturally independent, Indian communities still deeply distrust the country's notoriously corrupt political elite. In Panabaj, scene of an alleged army massacre 15 years ago, local leaders have said that soldiers are not welcome. Elsewhere, Guatemalan officials are left adding up the enormous costs of repairing roads, bridges and other infrastructure after the storm. That will be the easy part of their task. The enduring problems of rural poverty will be much harder to fix.

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Economist.com WORLD ASIA

South-East Asia's economies

In search of elusive domestic demand

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AFP

The region still depends on exports, which can be fickle

CONVERSATIONS about South-East Asia's economic performance tend to revolve around trade. A double-digit surge in exports helped to lift the region's growth to 6.3% last year. This year, a slowdown in exports, along with a bigger bill for oil imports, will cut growth to 5% or so. Economists hope that growing demand for electronic components and other exports will put growth on a rising path once more next year. But one thing is clear: “The region,” says Tim Condon of ING bank, “remains export-driven.”

It was not supposed to be this way. After the Asian crisis of 1997, when plunging currencies, free-falling asset prices and bankrupt banks had brought regional economies to a standstill, various national leaders—most notably Thaksin Shinawatra of Thailand—declared that South-East Asia should not look solely to exports to resuscitate its economic fortunes. Instead, Mr Thaksin argued, governments should try to revive domestic consumption, which would help insulate the region from the vagaries of the world economy.

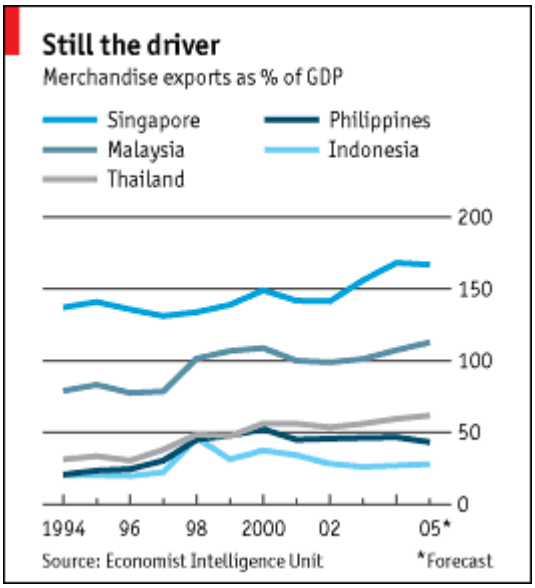
Mr Thaksin attempted to put this theory into practice by suspending farmers' debts, instituting cheap universal health care and handing out loans to villagers, small businesses and home-buyers. His government also began subsidising all manner of goods, from computers to cows, to increase Thais' spending power. Gloria Arroyo, the president of the Philippines, enthusiastically endorsed his ideas. New governments in Malaysia and Indonesia, too, promised to put more emphasis on “the grassroots economy”, to use one of Mr Thaksin's favourite phrases.

There is nothing wrong with these ideas, says Jesus Felipe of the Asian Development Bank. Indeed, he recently published a study showing that the economies of various Asian countries performed best, naturally enough, when both exports and domestic demand were buoyant. Last year, for example, domestic consumption and investment grew in tandem with exports in much of South-East Asia, propelling the region to its fastest growth since the crisis.

But Mr Felipe doubts that governments can bring about such an alignment by fiat. Instead, he argues that domestic demand tends to grow incrementally, in line with the economy as a whole. His study found that from 1993 to 2003, exports grew more than three times faster than consumption in Thailand, and accounted for over 70% of economic growth. This trend continued after Mr Thaksin came to power in 2001 and began implementing his policies designed to boost domestic demand.

The only country in Mr Felipe's study where exports did not make a significant contribution to growth was the Philippines, where almost all growth was attributable to domestic demand. But this is a sign of the Philippines' economic weakness, rather than strength. Consumer spending in the Philippines is particularly robust thanks to the billions of dollars of remittances that Filipinos working overseas send home to their families. But those workers are overseas in the first place only because the Philippine economy does not grow fast enough to provide jobs for them.

In general in South-East Asia, the richer the country, the higher the share of exports in the economy. Moreover, exports as a share of output are still rising steadily throughout the region (see chart), despite all the rhetoric about boosting the domestic sector. In the region's richest country, Singapore, they reached 168% of GDP last year. (Exports can be more than 100% of GDP because most of the components used to produce them are imported.) Net exports doubled their share of output in East Asia's richest countries between 1993 and 2003, from 5% to 10%.



Supavud Saicheua of Phatra Securities, an investment bank, argues that the Thai government has implicitly acknowledged that exports remain the country's chief engine of growth, by setting an export-growth target of 20% this year. Despite the slowing world economy, such an ambitious goal might prove attainable, thanks to the diversity of Thai exports in terms of both products and markets. Thailand sells both manufactured goods (cars) and agricultural ones (rice) to both rich countries (America and Japan) and poor ones (the other members of the Association of South-East Asian Nations). Much the same applies in the rest of the region. Malaysia exports palm oil as well as electronic components; the Philippines computer chips and fruit, and so on. Booming China is the region's fastest-growing export market.

Consumption, meanwhile, has faltered throughout South-East Asia in the face of rising fuel prices, which have fed inflation and prompted higher interest rates. Drought and bird flu have taken a toll on farming. Last year's tsunami and the recent terrorist attack in Bali have dented tourism. Governments have cut back spending, trying to balance their budgets. Consumer confidence in Thailand, for one, fell to its lowest level in three years in August. If oil prices started falling, and inflation and interest rates with them, consumption would doubtless improve. But that would also give the world economy a shot in the arm, and boost exports even more.

Economist.com WORLD ASIA

China's Communist Party plenum

Five more years

Oct 13th 2005 | BEIJING
From The Economist print edition

When is a programme not a plan?

Get article background

EVER since Stalin first unveiled an insanely ambitious one in 1928, five-year plans have been a staple of communist governments. But China, though still officially enamoured of Stalin, is in practice edging away from this legacy. To signal their embrace of the market, its leaders have just approved a five-year "programme" rather than, as in the past, a plan. The document is intended to mark a shift to a more sustainable growth model. Though perhaps not of Stalinist proportions, this is still an ambitious goal.

Despite attempts over the past two years to slow the pace of China's headlong growth, figures published this week by what used to be called the State Development and Planning Commission—since 2003 pointedly renamed the National Development and Reform Commission—suggest that it is still humming along. GDP growth in the first nine months is expected to reach 9.4%, it said, and could be 9.2% for the whole year compared with 9.5% in 2004. Year-on-year growth in fixed asset investments is expected to reach 23%, only three points lower than last year. Next year's GDP growth, however, could slow to 8.5%, the report predicted.

The five-year programme for 2006 to 2010, endorsed on October 11th by the Communist Party's Central Committee, by no means abandons the pursuit of high growth. But, according to a communiqué issued at the end of the four-day annual meeting, it is "essential" for China to "speed up the transformation of the economic growth pattern". Details of the programme are still secret (it will not be formally promulgated until the annual session of parliament next March). But officials say the transformation includes ensuring that growth is more evenly shared across the country, is less investment-driven and less polluting.

These are sound objectives. A fast growing gap between regions, and between rich and poor, is exacerbating social unrest (see article). Reliance on investment, usually aided by state-owned banks with a poor understanding of risk, has led to colossal waste and overcapacity. Rapid industrial expansion has exacerbated a critical shortage of water in many cities, and worsened environmental damage.

What can China's leaders do? Among the very few specifics suggested by the communiqué is a goal of reducing energy consumption per unit of GDP by 20% over the next five years, but that is easier said than done. More vaguely, it calls for "big improvements" in education and public health. The social security system, currently in tatters, should be put on a "relatively firm basis". How any of this will be financed is left unsaid. In a research report, Stephen Green of Standard Chartered, a British bank, says it is highly unlikely that China will intentionally pursue new policies, such as higher income-tax rates, that could undermine growth and job creation.

But Mr Green suggests that growth could suffer as an unintentional consequence of pursuing equality. In the past couple of years, privatisation has slowed down as a result of an outcry over

asset-stripping by managers of state-owned enterprises. The new document, unlike its equivalent that was issued by the party five years ago, makes no mention of any need to boost the private sector. Nor does it suggest, as the party did last time, that “orderly participation in politics” by citizens should be expanded.

This week's Central Committee meeting was the first at which China's president and party chief, Hu Jintao, who completed his assumption of power only a year ago, had a chance to set out his long-term plans in detail. China's state-run news agency, Xinhua, said they would bring about “revolutionary changes”. Perhaps: but the legacy of Stalin's love of hyperbole will last a lot longer than his economics.

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Economist.com WORLD ASIA

Protest in China

Democracy Chinese-style

Oct 13th 2005 | BEIJING
From The Economist print edition

Discord, even in the prosperous south

Get article background

SOME Chinese scholars call it the “gangsterisation” of Chinese villages. In recent years, reports of rural communities falling under the control of thugs, often with the support of local officials, have become increasingly numerous. A particularly egregious case in the southern province of Guangdong demonstrates the ability of well-connected thugs to withstand even the glare of publicity.

The prosperous village of Taishi, in Panyu municipality, a big industrial centre in the Pearl River delta, has become a focus of attention in recent weeks because of efforts by many of its 2,000 residents to replace their elected village chief. In July, some 400 signed a petition demanding his recall for alleged incompetence. This rare, but perfectly legal, move was even supported by a few newspapers in the province and endorsed last month by a regional edition of the Communist Party's main mouthpiece, the *People's Daily*.

Some local officials, including those in the village itself, were clearly unenthusiastic. Repeated protests by the villagers eventually prompted the authorities to arrange an election in September to create a recall committee that was supposed to meet this month to arrange a referendum. But thugs, apparently supported by village officials, began putting pressure on villagers and committee members. The committee resigned and support for the recall dried up.

On October 8th, a journalist from the *Guardian*, a British newspaper, accompanied by Lu Banglie, an activist who had been trying to promote the villagers' cause, was stopped from entering by a group of 30 to 50 goons, some wearing camouflage. They dragged Mr Lu from the car and beat him unconscious. The journalist was punched, but then allowed to leave. A bruised but apparently not grievously harmed Mr Lu was driven by officials back to his home province. A number of other Chinese lawyers and activists, as well as foreign journalists, who have tried to enter the village have been arrested or intimidated.

The authorities in Beijing rail from time to time against village-level thuggery, but their ability to control it is clearly limited. Yu Jianrong, a Chinese academic, said in a report in 2003 on rural gangsterism in southern Hunan province that village officials sometimes employ thugs to maintain order or exact taxes. Sometimes gangsters are appointed as village leaders by higher-level officials.

The authorities in Beijing are clearly embarrassed by events in Taishi. In late September, an internet bulletin board that hosted lively discussions on the issue was closed down. Meanwhile the village chief, with the backing of local superiors, remains in charge and determined to keep his fief from prying eyes.

Economist.com WORLD ASIA

China in space

Per obscura ad astra

Oct 13th 2005 | BEIJING
From The Economist print edition

China's secretive space programme alarms Japan

FOR the launch of its second manned rocket, China opened the doors of its secretive space programme—a crack. Unlike the first such lift-off two years ago, the event was broadcast live. As the *Shenzhou 6* and its two-man crew were propelled into a cold grey sky, the authorities' fears of an embarrassing failure in front of millions melted away.

But China is not yet ready to bare all. Only state-run television and radio were allowed to conduct the coverage. No foreign media were allowed anywhere near the launch site in Gansu province, about 900 miles (1,500 kilometres) west of Beijing, in the Gobi Desert. The date of the launch (October 12th) was announced only the day before; the time, just minutes in advance. What little had leaked out previously came mainly from small provincial newspapers.

State television did not even mention the possibility of a launch until the date was confirmed. The intended length of the mission has still not been officially announced. The government notified foreign journalists that if they had any questions about the mission, they should submit them by fax.

This venture, however, is clearly a more adventurous step for China than the launch of *Shenzhou 5*, which carried only one man into orbit for 21 hours. The latest mission is rumoured to be scheduled to last for nearly five days and involve 80 earth orbits. Astronauts Fei Junlong and Nie Haisheng (both fighter pilots) have moved from their seats to conduct experiments in a separate orbital unit that will remain in space after they return in the re-entry module.

It is also becoming clear that China has plans to become a space power. Yang Liwei, China's first astronaut, has said that *Shenzhou 7* is scheduled for launch in 2007 and will involve a space walk. The next mission will practise docking. Next year China is likely to launch a probe that will orbit the moon (a feat achieved only by Russia, America and Japan). It hopes to put an unmanned rover on the moon by 2012 and retrieve lunar samples robotically by 2020. Some reports talk of a human moon landing by then.

The speed with which China has developed manned space flight has surprised and alarmed Japanese policymakers. Shame was added to the mix when just a month after China's first manned flight, in October 2003, a Japanese rocket carrying two spy satellites had to be blown up, ignominiously, ten minutes after the launch when a booster failed to disengage. Further satellite launches were restarted only last spring.

For years Japan's space programme has dwindled, a consequence of budget cuts and of Japan's constitutional inability to develop anything that might have military applications. Japan now spends just $1.8 billion a year on its space programme, a fall of one-third from the peak: still more than China says it spends, but a fraction of NASA's annual budget.

China's progress in space has strengthened the hand of Japan's space lobby. In March, the

Japanese space agency, JAXA, under a new head, Keiji Tachikawa (who previously ran NTT DoCoMo, the country's mobile-phone giant), laid out its new vision for the next 20 years. JAXA wants a manned space programme, with a space station on the moon. Some Japanese policymakers argue that space is an area where much needed co-operation could actually take place between Japan and China. But there is precious little sign of that yet.

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Economist.com WORLD ASIA

The Yasukuni shrine

Stone of contention

Oct 13th 2005 | TOKYO
From The Economist print edition

A small improvement in Japan-Korea relations

Get article background

ANYONE who goes to a particular shady corner of Tokyo's Yasukuni shrine at 10am on October 15th will come across a curious sight. There, around a stone tablet some five feet high with a rock balanced on the top of it, the visitor will see South Korean officials, Buddhist monks and members of civic groups offering their veneration. This is curious, because Yasukuni is not simply a memorial to Japan's dead in all its wars; it is also the glorification of a half-century of Japanese militarism and aggression, of which the Koreans were the earliest victims.

“But this monument”, says one South Korean official, “is *our* shrine.” The stone is called, by the Koreans, *Bukgwandaecheopbi*, which means “monument for the great victory at Bukgwan”. The great victory took place on the Korean peninsula in 1592, and it was a rare one over a Japanese army. The victors were a raggle-taggle collection of volunteer local Korean farmers, monks and landlords led by a General Jeong Mun-bu, and the monument was raised a century later, with a detailed description of the fight against the Japanese engraved on the face of it.

Near Bukgwan it stood until the Russo-Japanese war of 1904-05, which was fought chiefly over Korea. The stone took the fancy of a Japanese general who shipped it back as booty; and soon it found its way to the Yasukuni shrine. There it languished anonymously until 1978, when a South Korean recognised it. From then on, civic groups and the South Korean government lobbied for its return. This week, in a tight-lipped ceremony, the Japanese government and the shrine's Shinto priests agreed, and in a few days the stone will be flown to Seoul and put on public display.

Its journey will probably not end there. For Bukgwan happens to be in North Korea. One official says that, so warm are relations now between North and South, that the monument might even make its way up on the first train if rail links are re-established, as planned, next year. And relations between South Korea and Japan? Despite this small gesture of returning the Bukgwan stone, says the official, so long as Japan's prime minister, Junichiro Koizumi, continues to visit the Yasukuni shrine each year, “a deterioration in relations at the highest level is unavoidable.”

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Sudan

Darfur's despair

Oct 13th 2005 | EL-GENEINA, DARFUR
From The Economist print edition

AFP

The plight of more than 2m Darfuris could worsen rapidly unless they are far better protected by African Union or other troops

Get article background

THE capital of West Darfur, el-Geneina, is hardly a beauty spot. There are canyons where the roads should be and plenty of rubble instead of houses. The only signs of prosperity are the offices and guest houses of myriad aid agencies. But the real scars of war and devastation lie on the edge of town: here are some of the scores of refugee camps that now disfigure the entire region of Darfur, legacy of the bitter war between rebels and the Sudanese government that broke out in 2003. In the past five weeks, violence has increased sharply again, and the African Union (AU), which has 6,000 troops in the country with a mandate, endorsed by the UN, to monitor a ceasefire and hold the ring, is still struggling to impose its authority.

There are now about 1.8m people in the camps of Darfur and a further 200,000 refugees just across the border in Chad. The camps were created to provide safe havens for those attacked and driven from their land in the conflict, but fear is now the prevailing emotion in many of them. In Riyad camp, just outside el-Geneina, where 15,000 live in precarious structures of palms, dried reeds and plastic bags, refugees talk of the risk of venturing out after dark and of the constant attacks by armed gunmen, who sometimes ride brazenly into the camp itself. An AU force, camped just about a kilometre (little more than half a mile) away, is meant to give some protection, but, says one 27-year-old man, “rapes still go on and they do nothing, just write reports”. He has good reason to be afraid: two weeks ago 35 refugees were killed in an attack on a similar camp.

For despite a formal ceasefire of a year's standing, between the rebel groups of the Sudan Liberation Army (SLA) and the Justice and Equality Movement (JEM) on the one hand and the Sudanese government in Khartoum on the other, everyone agrees that security has sharply deteriorated. The threat in Darfur is that the violence will soon jeopardise the continuation of humanitarian support for the refugees and destabilise a region that had only recently achieved a bit of equilibrium, if not exactly peace. And if chaos in the west increases, this year's historic but fragile deal between the government in Sudan and southern rebels, who have been fighting more on than off for 20-plus years, could also unravel.

The new wave of violence in Darfur has not only been directed, as it always has been, at the refugees, but at the aid workers themselves. At the beginning of last month, one aid convoy in West Darfur was ambushed by armed gunmen who looted everything, and then, says one of the victims, “systematically beat” the 23 aid workers, and sexually abused the women. This assault heralded a new level of violence against aid workers. Since then, many others have been beaten, whipped and kidnapped; one convoy was attacked on its outward and return journey to and from a camp. On October 8th two contractors were killed in an ambush. So, for the first time, were two AU soldiers, both of them Nigerians.

The result is that in West Darfur, for instance, which has 657,000 refugees, the UN and aid agencies are in a state of virtual paralysis in places like el-Geneina. According to Amy Horton, head of the UN's World Food Programme (WFP) in West Darfur, “travel south of el-Geneina is at a freeze due to the insecurity”. The WFP has now built up three months' worth of food supplies there, because it has become impossible to shift it to many of the outlying camps.

At the moment, thanks to the improvements in food supply and sanitation achieved in Darfur over the past year, few refugees are in immediate danger from this violent interruption. But NGO workers give warning that that could change very quickly if the present situation persists or gets worse.

Oxfam, for example, has three water and sanitation projects serving 90,000 people in camps south of el-Geneina, and had been unable for a month to send fuel to re-supply the generators that run them. It managed to get a convoy through this week, just before the existing stock of fuel ran out and the water system in several camps packed up. If it had not, the lack of clean water would almost inevitably have brought back disease and malnutrition. Of 16 camps in Darfur that Oxfam works with, six are inaccessible by road from the region's three main towns and supply centres. In West Darfur, not a single helicopter is available to ferry aid workers around.

Much of the violence is sheer banditry, committed by those who have nothing left to live off in a desert region razed by nearly three years of fighting. As a local tribal leader succinctly put it: “There is nothing left to loot apart from the NGO convoys.” More worryingly, there is plenty of evidence that the violence marks a return to the war's old battle lines. It was the Arab militia known as the *janjaweed* who killed the 35 people in the refugee camp two weeks ago. When war broke out two years ago, the *janjaweed* were armed by the Khartoum government and became its proxy fighters against the rebels. They killed thousands and committed most of the atrocities in the war.

The AU claims there is photographic proof of the Sudanese government's Russian-designed military helicopters strafing villages in conjunction with *janjaweed* attacks. This would add to the mounting evidence that not only has the Sudanese government done nothing to disarm these militias, as it is obliged to under the ceasefire agreement, but that it may be co-ordinating their attacks again. Sudanese officials in West Darfur deny this.

Not too many good guys

Meanwhile, the rebel SLA has also apparently started attacking government forces again. Not only that, but the AU accuses it of killing its two soldiers and the contract workers on October 8th. This is probably a result of peace-talks going on in Nigeria between the rebels and the Sudanese government, as different factions within the SLA jostle for advantage on the ground. For this reason there have been spikes in violence at the start of previous rounds of talks, but never to this level.

There is now little to prevent those who want to rape, loot and kill in Darfur from doing so. In reality, the AU force in Darfur, charged with monitoring the ceasefire, can do little with the resources at its disposal unless the Khartoum government actively helps it—which rarely happens. The Darfur region is divided into eight military sectors; in sector three, around el-Geneina, just 760 ill-equipped AU troops, mainly Nigerian, try to patrol an area of 12,000 square km (4,600 square miles). With almost no aviation fuel for its two helicopters, the AU force can do very little to protect civilians. The *janjaweed* still seem able to act with virtual impunity.

With the region so unsafe, many refugee camps are starting to take on an air of permanency, with schools, health clinics and small plots of family land. Despite ritual appeals by UN officials for funds to safeguard the refugees' return to their old lands and help them rebuild their old lives, most aid workers now concede that many of the refugees in the big camps around Darfur's three main towns—el-Geneina, el-Fasher and Nyala—may never go back.

The real test will come in the spring, when the refugees would normally return to their lands to sow crops for the next harvest. But Darfur may already have undergone a forced urbanisation, changing the region's demography. That means that the way of life—and survival—for millions of pastoral people has changed forever. Now they must rely on the goodwill of others, for security as well as food.

Peace talks in Nigeria between the Sudanese government and the rebel groups, now into their sixth round, sputter along. But, mainly because of the lack of unity between the various factions of the rebel groups, no deal looks imminent. Meanwhile, security on the ground needs addressing urgently, regardless of talks.

Many humanitarian groups want more of an international squeeze on Sudan's government, to make it meet its commitments under the ceasefire; it must be held responsible, too, for disarming the *janjaweed*, as it has promised but failed to do. The Sudanese have been blocking 105 armoured personnel carriers, donated by Canada, from reaching the woefully weak AU force, which sorely needs beefing up: it lacks every sort of equipment, from computers to helicopters, aviation fuel and even cash to pay its troops. Donors, mostly from the West, have been too slow to help strengthen it; a deadline to increase its strength to 7,000 was missed a couple of months ago. There are still only 800 civilian policemen in all of Darfur, which covers an area nearly as big as France.

Calls for a wholesale UN military intervention may get louder again. But Sudan's government would not, at present, accept the humiliation of what would be a largely western military presence; the AU force, for now, is the only game in town.

In any event, the AU force's mandate needs to be beefed up so that it can be allowed to go after the militias that kill civilians rather than just monitor a failing ceasefire. But the real problem is that the AU troops have yet to enforce their existing mandate. It has still to impose a disengagement plan on the two warring sides, let alone keep them apart. Yet, with a more robust interpretation of its mandate and with more cash and troops, it should be able to do more to help the millions on the verge of famine, death and despair. It is, indeed, the AU's biggest current test. So far, it is failing.

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South Africa

Biting the corrupt

Oct 13th 2005 | JOHANNESBURG
From The Economist print edition

Are South Africa's crime-busting Scorpions about to lose their sting?

Get article background

Reuters

The people's hero, so leave him alone

WHILE Jacob Zuma, South Africa's former deputy president who is accused of corruption, appeared in court this week, the fate of those who sent him there was also hanging in the balance. A commission headed by a judge, Sisi Khampepe, was hearing submissions to decide on the future of the Scorpions, the crime-fighting unit of the National Prosecuting Authority (NPA). Created in 1999 by President Thabo Mbeki to fight corruption and organised crime, the Scorpions may now be disbanded or folded into the regular police force, to the dismay of South Africans who want to make their country cleaner.

The Scorpions have some impressive scalps. They helped convict Nelson Mandela's former wife, Winnie, of fraud; ditto the former chief whip of the ruling African National Congress (ANC), Tony Yengeni. And due to their investigations, Schabir Shaik, a businessman who advised Mr Zuma, was convicted in June of corruption and fraud, leading to Mr Zuma's sacking as deputy president. The Scorpions have a reputation as fearless knights chasing well-connected crooks.

They also have their detractors. Mr Zuma's supporters say his prosecution is politically motivated. The police and the National Intelligence Agency accuse the unit of stepping on their toes and lacking supervision. During Mrs Khampepe's hearings, the justice minister, Brigitte Mabandla, who is responsible for the Scorpions, questioned the continued need for an entity outside the police force. She also said that the relations between the elite unit and other law-enforcement agencies had broken down “irretrievably”, an allegation denied by Vusi Pikoli, the NPA's boss.

For the liberal Democratic Alliance (DA), the main opposition in parliament, this is pure politics. It argues that the Scorpions, with their conviction rate of over 90%, are a success and should be left alone. The unit has its prosecutors, investigators and intelligence operatives working under one roof, and attracts high-calibre staff. That would rapidly cease if the Scorpions were folded into the police, says the DA. It also blames the government for turf wars within law-enforcement agencies and failures of accountability. The ministerial committee meant to keep an eye on such issues failed to convene until last year.

The hearings are due to conclude this week. Once the commission's suggestions are on his desk, Mr Mbeki must decide on the Scorpions' fate. With Mr Zuma's trial not expected until next year, they may not survive to see the conclusion of their most prominent case.

Iraq's constitution

Ballots amid bullets

Oct 13th 2005 | BAGHDAD
From The Economist print edition

Last-minute tweaks may make a new constitution a bit more widely accepted

Get article background

AP

Will they have time to read it, though?

FOR almost a year, Iraqi television viewers have been assailed by advertisements urging them to vote in various referendums and elections. Amid swelling nationalist music, they are told to fulfil these civic duties in order to defeat terrorism and give their children a better future. So it was a bit of a shock for them to see a new series of advertisements with a very different sort of message for the referendum on a new constitution on October 15th. Some urged them to "resist the occupation" by rejecting a document that would split the country and sow sectarian strife. They also complain that most Iraqi households have not even received a copy of it. How, asks one ad, can voters opine on something they haven't even read?

The mood in many parts of Iraq is far less enthusiastic than it was in the run-up to the general election in January, when 58% of Iraqis are reckoned to have voted, even though most Sunni Arabs, some 20% of the population, stayed away in protest or out of fear. Since then, ten months of car-bombings have shown that politics alone is no panacea. And more people feel they are being treated as a rubber stamp for the big parties in parliament, with little effort to involve them in the drafting of the constitution. The government's failure to distribute the document to many districts of Baghdad, let alone the centre and west of the country, where the insurgency is fiercest, has further soured them.

Partly this is because of frantic last-minute negotiations to tweak the document to make it more acceptable to aggrieved Sunni Arabs. They feel they have been done down by the Kurdish-Shia compact giving the Kurds extreme autonomy, while pleasing the Shias by giving the document not only an Islamist tint but also letting them (and Sunnis) form their own decentralised regions, further dividing Iraq to the detriment, they believe, of the Sunnis. The draft was supposed to be printed and distributed to homes along with monthly food rations, but a series of last-minute twiddles meant several further delays.

However adjusted, there is a lot in the document to annoy all-comers. Many Shia Arabs, as well as Sunnis, suspect federalism of being an American-Kurdish plot to break up Iraq. Most of the main parties now say they endorse the draft, as does the most influential Shia religious leader, Grand Ayatollah Ali al-Sistani, though a radical preacher, Muqtada al-Sadr, has offered no clear guidance. Many Kurds, though sure to vote yes, are cross that the document includes no right to secede.

But one final last-minute change may ensure the constitution's approval, perhaps even win it

some of the popular legitimacy it has so far lacked. Just four days before the vote, it was agreed that the next parliament, to be elected in December, will create a commission to review the constitution and propose amendments, to be confirmed in yet another referendum six months later. The latest deal also offers a further clutch of mostly symbolic sweeteners for the Sunnis, stressing Iraq's unity and Arab character.

The largest Sunni party, the Iraqi Islamic Party, now backs the document, though some influential Sunni outfits, such as the Muslim Scholars' Board, are calling for a no vote or a boycott. Sunni Arabs are now divided between yes, no and boycott camps, so the rejectionists seem less likely to muster the necessary two-thirds majority in at least three provinces to stymie the new constitution.

So the last-ditch amendments may give Iraq's constitutional drafters more time to try pulling more Sunnis back into peaceful politics and away from the insurgency. In any event, Sunni representation in the next parliament will rise. As the war drags on, more may turn against the suicide-bombers and others at the extreme end of the insurgency. That, at any rate, is the hope of Iraq's Shia and Kurdish majority—and of many ambivalent, fearful Sunnis.

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Economist.com WORLD AFRICA & MIDDLE EAST

Iran

Fighting among themselves

Oct 13th 2005 | TEHRAN
From The Economist print edition

Adversarial abroad, Iran's new president is being buffeted at home

“A KNIFE without a blade” is how Mehdi Bazargan, who headed Iran's first revolutionary government, described himself in 1979, and his words may strike a disagreeable chord with the new president, Mahmoud Ahmadinejad. Since he took office in August, parliament, influential unelected bodies and even members of his own cabinet have set out to blunt his egalitarian instincts and revolutionary zeal. At least Bazargan, a liberal, had the comfort of knowing that he was hemmed in by ideological opponents; when Mr Ahmadinejad speaks of “people who put spokes in the wheels”, he is referring to his friends.

Though they are, in the main, animated by the same conservative ideals as the president, many members of parliament backed rival candidates in the presidential election in June; they have been brazenly obstructive ever since. They started by withholding votes of confidence from four cabinet nominees whom they knew to be close to Mr Ahmadinejad. They decry his “security-based” approach to home affairs. And, on October 4th, they slowed the passage of two bills the government wanted to rush through parliament; one of them, which aims to dole out public-sector profits to struggling young couples, is the mainstay of the president's social policy.

Perhaps most ominous of all is the helping hand that Iran's “supreme leader”, Ayatollah Ali Khamenei, who is widely believed to have endorsed Mr Ahmadinejad's elevation, seems to be lending his tormentors. Last month, Mr Khamenei arranged for Muhammad Baqer Ghalibaf, a fellow conservative whom Mr Ahmadinejad defeated to become president, to become mayor of Tehran, the capital. (Defying convention, the president has not invited Mr Ghalibaf to cabinet meetings.) Then, earlier this month, Mr Khamenei gave the Expediency Council, an appointed body headed by a second defeated presidential candidate, Akbar Hashemi Rafsanjani, “supervisory” powers over all branches of government. One council member pointedly observed that “everyone is obliged to abide by [the council's] conclusions.”

No one is sure how often the Expediency Council will intervene in everyday politics or what the constitutional implications will be. What is clear is that, in many conservatives' eyes, the president is too inexperienced and too exuberantly ideological to be trusted with all the powers that are theoretically his. Some have also been particularly unnerved by his attempts to crack down on corrupt officials. For his part, Mr Khamenei may be transferring power and influence, often from elected institutions, to bodies he appoints. The result may be confusion, but of a stable kind.

For stability is needed after the shock of last month's meeting of the governing board at the International Atomic Energy Agency (IAEA), the UN's nuclear guardian, which was dominated by discussion of Iran's contentious nuclear programme. Board members confounded Iranian expectations by declaring Iran to be non-compliant with the Nuclear Non-Proliferation Treaty and by raising the likelihood of referral to the UN Security Council. In Iran, Mr Ahmadinejad was blamed for alienating supporters on the board with a tough speech that he had delivered before the UN's General Assembly. In Mr Rafsanjani's caustic words, the need is for “diplomacy, not slogans”.

Step forward Mr Rafsanjani. As a former president who favours negotiations over confrontation, he seems the ideal man to lower tensions and prepare Iranians for the concessions that may be necessary if UN referral is to be avoided. While Mr Ahmadinejad was hectoring in New York, Mr Rafsanjani was quietly assuaging fears in Saudi Arabia that Iran is trying to turn Iraq into an aggressively Shia state. His trip was apparently successful—and the Saudis obligingly snubbed Mr Ahmadinejad's foreign minister by suddenly postponing the visit that he had been scheduled to make.

In the run-up to the next IAEA board meeting, in November, Mr Rafsanjani will urge Mr Khamenei to rein in his hardline nuclear negotiator and to resume stalled negotiations with Iran's European interlocutors, who insist that Iran must re-suspend its nuclear work at Isfahan before the talks can start again.

At the same time, the Iranians are serving notice of the chaos that they can sow, should they choose, in Iraq. Britain detects Iranian expertise in armour-piercing explosives that have cost, so far, eight British lives, and suspects Iran of training militants that are now active there.

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Syria

A most significant “suicide”

Oct 13th 2005 | CAIRO
From The Economist print edition

The interior minister's death may weaken Syria's regime even more

Get article background

Reuters

He knew too much

SUICIDE is an oddly common exit for top Syrian officials. Five years ago, a recently disgraced prime minister, Mahmoud al-Zubi, managed to shoot himself, repeatedly, while under house arrest. Now the country's interior minister, Ghazi Kanaan, has met a similar fate. This latest death, however, is far more telling.

Mr Kanaan was both a ruthlessly seasoned intelligence operator and a member of the Alawite minority that dominates Syria's power elite. For 20 years until 2002, he virtually ruled Lebanon in his capacity as Syria's proconsul in the neighbouring state. A master manipulator of Lebanon's viciously contesting factions, he systematically bled Syria's enemies before helping to seal the accord in 1990 that ended 15 years of civil war and ensconced Syria as Lebanon's final arbiter. The ensuing peace, enforced by a security establishment that reported directly to Mr Kanaan, richly rewarded his friends, top Syrian generals and pro-Syrian Lebanese politicians alike.

Returned to Damascus as interior minister, Mr Kanaan was a pillar of the Baathist regime. But his apparent removal from the Lebanon file boded poorly for Syria's fortunes. Growing Lebanese resentment of Syrian tutelage erupted after the assassination early this year of Rafik Hariri, Lebanon's most prominent post-war politician, which many Lebanese instinctively blamed on Syria. International opprobrium forced Syria to pull out troops and undermined the patronage network created by Mr Kanaan, such that the Lebanese elections this summer produced a determinedly anti-Syrian government.

More damaging yet, a UN-backed probe of the Hariri murder fingered the Lebanese security chiefs that Mr Kanaan had put in place. Last month, the UN's chief investigator, Detlev Mehlis, pressed his inquiries still closer. Bowing to intense diplomatic pressure, Syria's president, Bashar Assad, let him question senior intelligence officials, including both Mr Kanaan and Rostom Ghazale, his successor in Lebanon until the Syrian withdrawal.

The outcome of these interrogations remains unknown; Syria loudly denies any involvement in Mr Hariri's killing, and Mr Mehlis is not due to report to the UN Security Council until October 25th. Speculation has mounted, however, as to how Mr Assad's fragile regime may respond to its possible implication in the Hariri murder, and to consequent demands to surrender officials for trial. Because the government in Damascus is diplomatically isolated, and squeezed militarily between Israel and America's forces in Iraq, Mr Assad may find it wise to offer a scapegoat to the investigators. In a recent interview, he said that if anyone in his government were found to have

“acted alone”, it would be considered treason, punishable by death.

Just an hour before his death, Mr Kanaan telephoned a Lebanese radio station to deny reports that he had passed UN investigators extensive files on corruption in Lebanon during his tenure. “I think this may be the last statement I give,” he concluded. Indeed.

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German politics

A difficult pairing, an uncertain outcome

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From The Economist print edition

AP

Germany's new coalition could be more, or less, than the sum of its parts—as its chancellor-in-waiting, Angela Merkel, knows too well

Get article background

ASKED how political coalitions are formed, Germany's chancellor, Gerhard Schröder, once shot back with a question of his own: “How do porcupines mate?” After a short pause, he then answered it with a grin: “Very slowly.” The coupling of these prickly creatures is probably an accurate enough metaphor for current political events in Germany. Having fought each other tooth and quill for more than three decades, the Social Democrats (SPD) and Christian Democrats (CDU)—along with Bavaria's Christian Social Union (CSU)—are now coming together in an awkward embrace.

After a three-week-long mating dance, they finally got serious on October 10th, with a decision to make the opposition leader, Angela Merkel, the new chancellor and start formal talks on a partnership. Yet it will take at least another four weeks before this union is fully consummated: many decisions have yet to be taken, including the composition of the cabinet.

Some things in German politics remain constant, not least Mr Schröder's penchant for dramatic outbursts. In an emotional speech on October 12th, he confirmed he would not be part of the new government—and denounced “Anglo-Saxon” economic policies which, he insisted, would never work in Europe. Attacking America's response to Hurricane Katrina, he said it was a case of what happens “when the organised state is absent.”

The chancellor's temperament aside, almost everything is in flux—but at least things are moving in the right direction. After the election on September 18th, it seemed that Germany had voted itself into a corner: the governing coalition of SPD and Greens had lost their majority, while the opposition of CDU/CSU and Free Democrats had failed to win one of its own. Even last week, after the opposition won an additional seat at by-elections in Dresden on October 2nd, Germans were still bracing for many weeks of political gamesmanship. The SPD insisted that Mr Schröder remain at the head of the government, while the CDU/CSU did not even want to start real negotiations until he was pushed aside and Ms Merkel had been accepted as the new chancellor.

Yet over the weekend, both politicians, as well as Franz Müntefering and Edmund Stoiber, the bosses of the SPD and CSU respectively, reached a power-sharing deal that essentially cuts the differences in half. Ms Merkel will become Germany's first female chancellor and the first from the country's ex-communist, eastern part—crowning a breathtaking political career that began only 15 years ago, after German unification. In return, however, the CDU/CSU has had to pay a high political price. The SPD will get more policy portfolios: eight versus six. It will control some of the weightier ministries (such as foreign affairs, finance and justice), while the CDU/CSU will have to content itself with some less prestigious ones (such as economics, interior and defence).

Equally important, Ms Merkel has had to make big policy concessions, although insiders insist that they are only tactical in nature. At any rate, a four-page memo summarising the negotiations offers comfort to the SPD on many points that the party (especially its left wing) holds dear. Yes, the new coalition would simplify Germany's baffling tax system and do away with many tax privileges—but not the exemption for extra pay for night and holiday shifts. There are also plans to facilitate company-level wage deals (as opposed to sector-wide bargaining), but this change will not be mandated through legislation, as the opposition had originally intended.

Taking their time over it

At a pace which seems rather leisurely—Germany has been in political paralysis since Mr Schröder opted for early elections last May—the parties have set November 12th as a deadline to come up with a final cabinet list and negotiate a detailed coalition agreement. And it will probably take at least another week until the Bundestag, Germany's lower house, will be able formally to elect the new chancellor, who will then pick her cabinet: the whole deal first has to be approved by congresses and the parliamentary groups of all three parties involved.

Given the long and arcane procedure, much can still go wrong before the new government is in place. For one thing, drawing up a cabinet list will be a tortuous affair—for the CDU/CSU because of the paucity of portfolios, and for the SPD because its bank of talent is so near to being empty. Only Mr Stoiber knew early on what portfolio he would get: the economics ministry, which will be extended to include technology and harmonisation with the European Union. (At the same time, this ministry will be stripped of its recently acquired responsibility for labour affairs, leaving that job for the Social Democrats.) As for the other five ministries for the centre-right, even Ms Merkel herself seems not to have made any decision: “I'll tell you when I've finished thinking,” she said disarmingly this week.

On the SPD side, several ministers are going to keep their jobs, notably Ulla Schmidt (health and pensions) and Brigitte Zypries (justice). Mr Müntefering will become deputy chancellor, and also labour minister. Peer Steinbrück, ex-premier of North-Rhine Westphalia, is set for the tough job of finance minister. Frank-Walter Steinmeier, a prudent aide of the outgoing chancellor, has been nominated by the SPD as foreign minister.

Mr Schröder's supporters would have liked him to take the deputy chancellor's job, but he balked at serving under Ms Merkel. Still, he will remain part of the negotiating team—to help make the

grand coalition a success, or so he has said. His departure underlines the fact that the SPD's pool of expertise is severely drained. Mr Müntefering, who is already badly needed to keep the parliamentary group and the party under control, will now have his hands full with two top jobs. Matthias Platzeck, the premier of Brandenburg, and one of the SPD's few real political stars, flatly refused to accept any of the senior positions on offer.

The government agenda also risks looking all too familiar. Since Mr Schröder lost the election mainly because of his reform package called Agenda 2010, and Ms Merkel didn't win it because she had announced that she would push reforms even further, the mood is not in favour of experiments. Yet it may still prove difficult to get agreement through the parties' congresses. The CDU will probably approve a deal on November 14th, although there is criticism that Ms Merkel paid too high a price for becoming chancellor. Her internal opponents—Christian Wulff and Roland Koch, the premiers of Lower Saxony and Hesse respectively—could still try to attack her if she runs into difficulties.

What will happen at the SPD's meeting in mid-November is even less clear. The party's mainstream had vowed never to vote for Ms Merkel and is worried that the SPD accepted too many difficult portfolios while letting the other side take potentially more popular jobs. Meanwhile the left wing may quickly realise that its position in a grand-coalition government will be as weak as under Mr Schröder. And the SPD has a history of tumultuous party congresses, occasionally ending in fisticuffs. In 1968, when it met to vote on Germany's first grand coalition (1966-69), Herbert Wehner, then the chairman of the party's parliamentary group, ended up with two teeth missing.

All this raises the question of what will happen if the political porcupines fail in their attempted coupling. In this case, it will not only be the protagonists that end up scarred—but Germany's democracy, too. The immediate result would probably be new elections—and in the longer term, a loss of confidence in the country's main political players, apparently incapable of getting their act together, even when the entire nation is urging them on.

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Germany's far right

An untamed beast

Oct 13th 2005 | REINHARDTSDORF-SCHÖNA, SAXONY
From The Economist print edition

The neo-Nazis haven't gone away

AFP

Mind those Turkey-bashers

Get article background

ONE of the things people always say about grand coalitions in Germany is that they risk pushing malcontents towards the political extremes. So how big a challenge does Germany's far right now pose?

The good news from last month's German election was that the neo-Nazi National Democrats (NPD) won only 1.6% of votes, well below the 5% needed to enter parliament. Paradoxically, the movement may have been hit by the new Left Party, which chased far-right voters. But it would be wrong to assume the NPD is reverting to obscurity, after winning a disturbing 9.2% of the vote at a state election in Saxony a year ago.

Most Germans worry about far-right parties only when they win more than 5% of the vote, says Toralf Staud, the author of a book on the NPD called “Modern Nazis”. The big danger, he argues, lies not in the risk that the NPD will one day win seats in the Bundestag, the lower house, but in its efforts to promote fascism in some east German regions.

The NPD may be Germany's oldest neo-Nazi party, but its strategy is modern. It is no longer a sect seeking only to defend the Third Reich. It has rebranded its old xenophobia by including the rhetoric of resistance to global capitalism. Another fashionable cause is opposing Turkey's entry into the European Union.

A jumper on band-wagons, the party has backed protests against labour-market reforms and the war in Iraq. The NPD has also found a place in far-right youth culture, which now consists of more than skinheads in bomber jackets: its symbols are fashion brands, football loyalties and, above all, music. Music is the NPD's way of attracting youngsters. It recently handed out 200,000 copies of a CD called “School Yard”, a medley of rock songs and nationalist ballads.

It is in “Saxon Switzerland”, a mountainous area near the Czech border, that the NPD has had its biggest impact. And it is in Reinhardtsdorf-Schöna, a village of 1,600, that the party got its best result in last year's local elections: more than 25%—enough for two seats on the local council. Nationalism is cool among local youth. Feting Hitler's birthday is one of their pastimes; if your skin is the wrong colour, this place could be perilous.

Few of the burghers of Reinhardtsdorf-Schöna are neo-Nazis. Yet resistance to the far right is picking up only slowly, partly because some fear that discussing it openly could hurt tourism.

However, a “citizens' initiative” is now warning people about the NPD's rise. At a reading of Mr Staud's book in a local bar, people exchanged ideas about what to do. “We have to stop looking away when we see young people in their right-wing gear, but talk to them,” said one woman.

Curbing right-wing extremism will take time, says Mr Staud. And it needs attention not only at times when the NPD does well. Despite its poor showing in Saxony (4.9%) and Reinhardtsdorf-Schöna (14.4%) in the general election, the party topped a recent straw poll among youths under 18 in Saxon Switzerland, with 28.1%.

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Economist.com WORLD EUROPE

Estonia and Slovenia

When small is beautifully successful

Oct 13th 2005 | LJUBLJANA AND TALLINN
From The Economist print edition

The richest state in ex-communist Europe wants to copy the fastest-growing one

Get article background

SMUG, small and thriving, Estonia and Slovenia share a lot. Both escaped in 1991 from large communist entities in which they were the richest bit: from Soviet occupation in Estonia's case, and from federal Yugoslavia in Slovenia's. That left both of them with marked superiority complexes: Estonians (all 1.3m of them) love explaining how much more western, wired and competitive they are than their ex-Soviet counterparts. For their part, Slovenians (2m) relentlessly underline their Alpine and central European heritage. (Never, ever call them Balkan.)

To be fair, each has a lot to be proud of. Brushing off outsiders' scoffing, they have created stable, prosperous countries with strong institutions. Slovenia is much the richest post-communist country, while Estonia's economy showed 9.9% year-on-year growth in the latest quarter—Europe's fastest rate. Both are in the EU and NATO. By 2007, both want to adopt the euro.

Estonians, twitchy about Russia, have long envied Slovenia's wealth and security. But now the tables are turning. Slovenia wants Estonian-style growth. The current rate, a projected 3.9% this year, will not match west European levels fast enough. Worse, other post-communist countries are catching up. “We are losing our first place,” says the prime minister, Janez Jansa. He blames the gradualist approach of past governments. Having just returned from the Baltic states, he speaks of Estonia as “a good example for us”.

One thing he would like to copy is Estonia's flat tax of 24% on personal and corporate income. Filing an annual tax return online, as 80% of Estonians do, takes a few minutes. “Our tax system is so complicated that even experts can't understand it, let alone foreign investors. And it takes from March to October to have it processed. In Estonia it's five days,” says an envious Slovene official.

The second thing that struck Mr Jansa was Estonia's economic openness. That dates from 1991, when it had to start from scratch after the Soviet collapse. It privatised almost everything, shunning tariffs, subsidies, bail-outs and restrictions on foreign ownership. That brought huge foreign investment and a manufacturing boom, as well as thriving service industries and a large niche in the new economy. Skype, an internet telephony company, is based on software developed in Estonia; its development centre in Tallinn employs 100-plus geeks, and its Estonian shareholders are now multi-millionaires. There is talk of a $1 billion stockmarket launch for another company, Playtech, which designs internet-gambling software.

Strong export businesses made Slovenia so rich in the Yugoslav era that it didn't seem quite communist. Now it doesn't feel quite capitalist. Although it boasts the region's best port, plus world-class makers of furniture, domestic appliances, and medicine, it has pampered, wobbly banks and creaky service industries. One reason is continuing state influence in the economy. Another is that insiders, not foreigners, are the main owners. Competition is weak and innovation lags; there is nothing like Skype. Mr Jansa blames, with some justice, the cosiness of “old networks” from Yugoslav days. Some, he says, are linked to the former intelligence services.

Mr Jansa's third big idea is reform of public administration. He was impressed with what Estonia calls e-government: the idea that mouse-clicks, not queues outside offices, are the best way for citizens to meet the state. That often impresses outsiders, at least on the surface. Many votes in this weekend's local elections in Estonia, for example, will be cast online. Yet the system is far from perfect: though Estonian institutions set up from scratch do indeed tend to be ultra-efficient, those inherited from Soviet days—like the xenophobic immigration authority—are anything but.

Mr Jansa, a fan of Estonia's administrative “simplicity”, is trying to catch up. He has introduced online registration for entrepreneurs, and a law to cut form-filling: “If data is already in the system, it is the state's duty to find it, not the citizen's duty to provide it again.”

Slovenia's sleepy and inward-looking public institutions are certainly ripe for change. In the global higher-education market, for example, Estonia boasts dozens of institutions (admittedly, of varying quality) offering competitively priced, multilingual courses. Some attract students of medicine and veterinary science from next-door Finland; increasingly, Asians come too. By contrast, independent higher education in Slovenia is held back by gruelling bureaucratic obstacles. The main university insists stodgily that all courses be taught in Slovenian.

Some reform-minded Slovenes doubt Mr Jansa's commitment to change. He was elected on a radical liberalising manifesto last October, but so far there has been little to show for it. And many features of Estonia, such as run-down health care, bad roads and a wholly deregulated labour market would horrify Slovenes, who pride themselves on high-quality public services. Estonians themselves fret about corruption and government complacency.

For all that, it is rare and welcome for a post-communist politician even to consider learning from another country. Most of them, especially those in big countries, insist that their problems are unique. That is almost always wrong.

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Italian culture

A new patron, please

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Private sponsorship may be the only hope for cash-starved culture

EVEN for strike-hardened Italians, there is an element of novelty in the stoppage which has been called for October 14th. Theatres, cinemas and opera houses are to close in protest at what an actress, Mariangela Melato, has called a “disaster for all of us and the whole of Italian culture”.

As details of Italy's 2006 budget have trickled out, it has become clear the arts have again been singled out as the prime target for spending cuts. Last year, the cuts were painful enough to elicit a threat of resignation—never actually carried out—from the then culture minister. This year, they go even deeper.

The bill drawn up by Giulio Tremonti, who returned to his old job as finance minister after his predecessor quit last month, would shrink the main kitty for the performing arts, known by its acronym as the FUS, by about a third. Among internationally renowned institutions affected are the great Milan and Venice opera houses, La Scala and La Fenice; Milan's Piccolo Teatro; and the Accademia Nazionale di Santa Cecilia in Rome.

None of these mighty centres of excellence is funded solely from the FUS. La Scala, for example, gets lottery money. But the budget also forces big cuts on the regional, provincial and local authorities that supply roughly half of the funding for culture in Italy.

Massimo Cacciari, mayor of Venice and president of La Fenice, said he would be left with “only the money to pay the staff”. Bad news for opera lovers. But should they expect their passion to be bankrolled by other taxpayers?

Definitely, says Severino Salvemini, who lectures on cultural economics at Milan's Bocconi University. “For Italians, investment in culture is almost a productive investment,” he says. “The more we become a society whose output relies on aesthetics, the more culture becomes a contribution to competitiveness.”

Perhaps, replies Eleonora Belfiore, of the Centre for Cultural Policy Studies at Britain's Warwick University. “All sorts of claims are made for the economic value of culture,” she notes. “But whenever economists have studied these claims, they have found there is very little hard evidence to support them.”

However, she agrees with Professor Salvemini on one thing: while cutting off public money to the arts, Silvio Berlusconi's government has done too little to ensure the funds are replaced with private largesse. After four years of conservative government, individuals still cannot set patronage of the arts against their tax liability, and the fiscal incentives for corporations are more theoretical than real.

According to the Council of Europe, there is proportionately less private cultural sponsorship in

Italy than in Germany or Britain, though more than in France. Much of this private money goes on heritage conservation, and what is left cannot be increased overnight to make good cuts of about 30%. But to be true to its own principles, the right-wing government could at least make a start. This would show how much individual and corporate generosity, properly harnessed, can benefit the arts—in a country whose heritage owes so much to patrons with deep pockets.

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Russia's hot spots

Caucasian dominoes

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Havoc spreads from Chechnya to another part of the north Caucasus

UNTIL recently, the southern Russian city of Nalchik was a sluggish place where the local authorities more or less kept the lid on ethnic and religious tension. But on October 13th, gun-battles broke out in the capital of Kabardino-Balkaria, a semi-autonomous republic in the north Caucasus mountains.

Details were hazy as *The Economist* went to press. Early reports in Moscow spoke of the armed seizure of a school, as happened at Beslan, in the neighbouring region of North Ossetia, in September 2004. But it later seemed that the attackers' targets had instead been an arms shop and assorted federal and security installations, including police stations and the local department of internal affairs. A Chechen website claimed that all those places were assaulted simultaneously by Muslim fighters of the “Caucasus Front”.

Witnesses reported bodies being ferried in cars, blasts across the city, helicopters hovering overhead, buildings ablaze and gunmen car-jacking passing vehicles as they tried to flee. A Kremlin official said hostages had been taken. The numbers of insurgents (possibly hundreds), and of casualties (at least scores), are yet to be confirmed.

Given the self-exculpating misinformation that Russia's government emits after such incidents, the details may stay murky. But the trend is clear: violence once confined to Chechnya, where Russia has fought two grisly wars against separatism, has spread across the entire north Caucasus region.

Though there have been gun-battles and sieges in Nalchik before, the city was until recently deemed safe-ish, at least compared with Grozny in Chechnya. Kabardino-Balkaria now looks as brittle and unstable as Ingushetia and Dagestan, Chechnya's other neighbours, where shoot-outs and killings abound.

As night follows day, Russia's government will blame “Wahhabis” (Russia's catch-all term for Muslim extremists) for this week's strike. The creation of a pan-Caucasian conflict, and subsequently a caliphate, is indeed an aim of some Chechen terrorists . The scale and boldness of the Nalchik havoc certainly point to a Chechen connection, and perhaps to the involvement of Shamil Basayev, the organiser of the Beslan attack. Grabbing arms, freeing prisoners and showing strength are among the likely motives.

But indirectly, the culprits are the local and federal authorities. The tactics used in Chechnya, and then in nearby Ingushetia, have been applied in Kabardino-Balkaria too, with predictable,

alienating results. In the past year, large groups of “suspects” have been rounded up and brutalised; the security services harass and torture with impunity. Meanwhile, the corruption which lets terrorists slip across internal borders has crippled the local economy, monopolising business for the elites, creating deep resentment and unemployment, and feeding extremism. President Vladimir Putin last month replaced Kabardino-Balkaria's veteran ruler with a businessman—perhaps on the dubious principle that rich people can resist corruption.

The attackers in Nalchik were said to have blown up a monument to Russian-Kabardine friendship. Their dream of a pan-Caucasian caliphate may be fantasy, but the widening of an arc of pain and instability is all too real.

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Charlemagne

Don't just bash the bureaucrats

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Politicians are playing a cynical game when they call Brussels the enemy

AS THE barrage of populist attacks becomes deafening, José Manuel Barroso, the president of the European Commission, sounds like an artilleryman who can tell the sound of every shell. He identifies “two kinds of populism—one that is against the market, [and] the other that is against the very idea of Europe and wants to put the blame on the institutions of Europe.” Olli Rehn, the commissioner in charge of enlargement, puts it another way: “We are at the bottom of the cycle, and populism is at its height.”

It is tempting to tell them to stop whingeing. For years, the commission has taken fire from politicians in every corner of the European Union. In a way, that is its job. Opaque, obscure and obtuse, there are times when it has merited some well-aimed shots. At other times, remaining calm and stoical in the face of enemy shells is part of a game in which its “adversaries” collude. Time and again, finance ministers have sidled up to commissioners and muttered: do strike down this bit of state aid, or that case of fiscal nonsense, because we can't do it ourselves—though you must understand, we'll have to criticise you in public.

But this arrangement, in which politicians pretended to criticise the commission and commissioners pretended to care, depended on national politicians wanting the same things as European ones, and on the EU possessing a store of goodwill it was willing to expend on essential-but-painful measures. Over the past few years, both conditions have changed.

Unfriendly fire

Starting in about 2003, when the leaders of France, Germany and Britain got together to bash the EU's industrial policy (even though the trio differed on what that policy should be), politicians have been increasingly willing to slam the commission for no higher purpose than to distract attention from their own problems. The latest attack—the one that occasioned Mr Barroso's rejoinder—was an example. Jacques Chirac laid into the EU bureaucrats because, he said, they did not care that Hewlett-Packard, an American computer company, planned to axe a quarter of its French employees. In this case, there was no question of the government in Paris needing the commission as an alibi for hard decisions. Nor did the EU have a power to intervene that it failed to use. It had no authority—but still got blamed.

That is hardly the first time. But now the commission cannot afford to walk into the line of fire for its masters as it used to. The Barroso commission is unusually weak. Mr Barroso himself lacked the support of France or Germany when he was chosen as president. Few commissioners are political heavyweights back home. Above all, the Euro-constitution's rejection by French and Dutch voters has started an open season on all things European, and the commission has been first in line.

To the extent that the new populism reflects problems with the commission, the damage is still containable. Because the commission is weak, it has failed to argue effectively for freeing trade in services; it has also been tempted into weird trade-rigging arrangements, like the recent deal on textiles with China. But on balance, its critics have not pushed the EU into protectionism or statism; mostly, the commission has held the line.

The bigger worry is that populism reflects a problem with national governments—specifically, their inability to come to terms with globalisation. As a result, populism is appearing in domestic politics in the form of economic nationalism and anti-capitalist rhetoric. The best known examples come from France, where the president says “liberalism is as dangerous an ideology as communism, and like communism it will not prevail.”

But similar talk is heard in Germany. On the hustings, the outgoing chancellor, Gerhard Schröder, denounced “wage dumping” and “exploitation”. He lost, but only just. In a tearful political farewell this week, he said Anglo-Saxon economics had “no chance” in Europe. As Jeffrey Gedmin of the Aspen Institute in Berlin observes, the anti-capitalist rhetoric of this year's German campaign matched the anti-American tone of the last one.

When top politicians succumb to populism, that encourages a public opinion that seems all too ready to believe that globalisation is nothing but a disease. All Europeans live in a globalised economy and benefit from free trade. Yet according to the EU's public opinion arm, the word “globalisation” conveys negative images for nearly half of them, versus only a third for whom it is positive. A recent Euro-poll asked people to name the first thing they associated with globalisation: the loss of jobs to low-wage countries, most replied. They had a similar image of the EU itself.

What seems to be emerging, especially in some large European countries, is a crude dichotomy: on one hand, globalisation and “Europe”; on the other, national governments and economic populism. The first pairing is reasonable enough: the EU is, on balance, a force for globalisation. The other—linking populism and domestic politics—is disturbing.

Increasingly, it means nobody—except hapless Eurocrats—is reminding voters that open markets underpin both Europe's prosperity and the “social models” people want to defend. Rational debate about economics is harder when even modest free-marketeers, such as Britain's Tony Blair and Mr Barroso, are demonised. Above all, this distracts attention from the real problems facing Europe, which are national ones. Improving labour markets, reforming pensions, and all the other things needed to create jobs and boost growth, have to be the province of governments. By blaming the

EU, as Mr Chirac did, national politicians make it seem as though the problem lies elsewhere.

In the past, national governments were on the same side as the EU but pretended otherwise, in order to get good policies implemented. Now, too many are putting themselves on the opposite side, and highlighting their differences—with the conscious intention of making good policy harder to achieve.

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Economist.com WORLD EUROPE

National Health Service

Stressed out

Oct 13th 2005
From The Economist print edition

The NHS's financial difficulties highlight why reforms are so urgent

Get article background

AT THE general election in May, Labour convinced voters that it should be given a third chance to sort out the National Health Service. Since then, however, there have been some worrying signs that things are not going to plan.

A recent survey of medical directors by the British Medical Association (BMA) painted a depressing picture. Three-quarters of those working in acute-care hospitals reported that their trusts were facing a funding shortfall. Some 40% said this would lead to a recruitment freeze and around 25% that their trust was considering redundancies.

The spectre of financial famine appears perplexing at a time of financial feast. Record sums of money are coursing into the NHS. Since 1998, cash spending has risen by nearly 10% a year, equivalent to real annual increases of over 7%. The Treasury is committed to keep boosting the health budget at around these rates until the financial year ending in spring 2008.

Against this background of tax-funded abundance, critics of the government, not least the BMA, are suggesting that reforms to inject more market forces into the NHS are to blame for its financial problems. The doctors' trade union is too modest. A big reason for the distress is the BMA's success in negotiating lucrative pay deals for its own members.

New contracts for hospital consultants and family doctors (GPs) are proving far more costly than the government expected. The consultants have got a large pay increase for very little so far in return, says John Appleby, an economist at the King's Fund, a health-policy think-tank. GPs are now earning £100,000 ($175,000) a year on average from the NHS according to AISMA, an association of medical accountants. Their income has been lifted by a big increase in performance-related pay, which Chris Ham, professor of health policy at Birmingham University, says is much more generous than in other countries. With nurses and other NHS workers also getting a boost in earnings, higher pay accounts for about half the increase in this year's budget, estimates Mr Appleby.

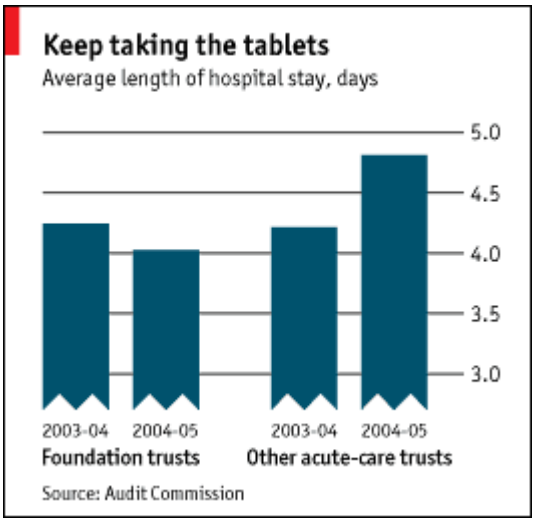
The NHS is in a financial fix not because of reform but because of a lack of it. Not before time, that is starting to change. One step is the introduction of a new payments system. Until this year, most hospital trusts were paid through “block contracts” which mainly reflected previous budgets, adjusted for cost inflation, with no direct link to how much work they actually did. But since April, every patient admitted for elective (non-emergency) operations has had a price-tag attached to his treatment, so that hospitals are rewarded according to how busy they are.

The potential gains in efficiency are well worth having. “Payment by results” will generate strong pressures within the NHS to boost efficiency as relatively expensive hospitals strive to push down their costs and cheap ones try to get more business. According to a report this week from the

Audit Commission, a public-spending watchdog, the introduction of a similar system in Australia resulted in a big productivity improvement.

The new payments system was used in 2004-05 for both elective and emergency admissions to foundation hospitals, a select group that have won more freedom to run their affairs. Already, there are signs that it is starting to work. Foundation trusts cut the length of hospital stays in 2004-05, whereas it rose among other hospitals (see chart).

Foundation trusts are also improving their performance because they now face more rigorous financial discipline than other hospitals. But the commission expects payment by results to encourage similar efficiency gains to those achieved in other countries. James Strachan, its chairman, said on October 10th that the new system is "fundamental to the modernisation of the NHS".



However, this positive endorsement drew less attention than worries in the report that payment by results may destabilise NHS finances at local level. There are two main risks. Primary-care trusts (PCTs), the 300 local organisations that purchase hospital treatments, could face a funding shortfall if hospitals do more work than budgeted for. Hospitals, for their part, will run into trouble if they fail to get enough work or to control their costs.

The government has already delayed the full implementation of payment by results in most acute-care hospitals, deferring its use for emergency care until next April. The commission suggests that it could be introduced then in a less stringent form, by including, for example, a standing charge for emergency capacity. A snag with this proposal is that hospitals may then try to shift some of their overhead costs on to the emergency-care budget.

The government is determined to press ahead with payment by results. Indeed, Patricia Hewitt, the health secretary, has said that any instability that it will create is an essential part of raising efficiency. Ministers are planning to try to restrain demand overruns in other ways. By the end of next year, the number of PCTs, which have sometimes been ineffective, is to be cut by half. More important, GP practices will be playing a much bigger role in commissioning treatments, with budgetary incentives for them to lower costs.

Careful, this might hurt

In a report published on October 12th, the OECD said that the government should build on payment by results with further reforms to pep up efficiency. It advocates tying earnings for hospital doctors more closely to their productivity through fee-for-service payments and says that further expansion of private-sector provision of NHS health care may be necessary.

The OECD also calls upon the government to slow the growth in the country's health budget. In his review for the Treasury in 2002, Sir Derek Wanless envisaged that real spending would continue to rise at an annual rate of 4.4-5.6% in the five years after 2007-08. According to the OECD, this would mean average real growth of 6-6.5% in the 15 years to 2012-13, which among the advanced countries would be an unprecedentedly big increase over so long a period. It questions whether the NHS can absorb these extra resources without cost-inflation and waste, and says it would be better if growth were to slow to 2.5% a year after 2007-08.

The Treasury recently confirmed that it will revisit the Wanless review as part of its spending settlement in 2007. The NHS has to prepare for a stretch of modest years after so many abundant ones. Which is why it must become more efficient.

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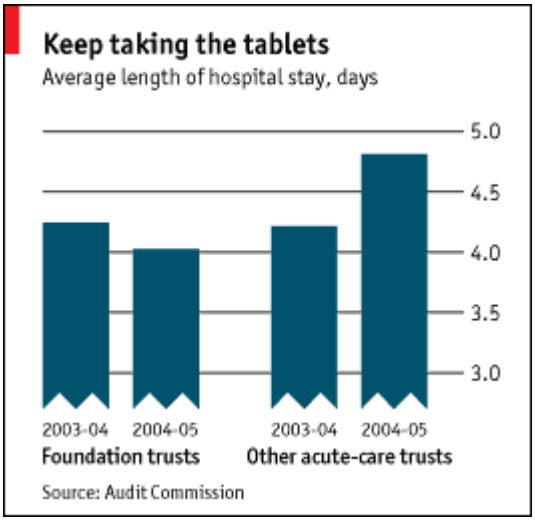
Economist.com WORLD EUROPE

Euthanasia (1)

The policeman's dilemma

Oct 13th 2005
From The Economist print edition

Is it better to help someone die or leave them in unendurable suffering?



A LORRY-DRIVER is trapped in the cab of his burning vehicle after an accident. The police, fire-fighters and ambulance service are at the scene, but it is clear he will burn to death before he can be freed. He is in agony. He begs a policeman (who happens to be armed) to shoot him rather than let him burn. The officer does so. This choice—between killing someone and leaving them to die in unbearable pain—is known as the "policeman's dilemma".

It is difficult to imagine anyone, however religious, condemning the policeman's conduct as wicked. Yet, argue the supporters of Lord Joffe's private member's bill on assisted suicide shortly to be introduced to the House of Lords, if society concedes that, then it concedes the principle of assisting death in extreme distress, where the condition is clearly terminal—as the lorry-driver's was. Only in very rare cases, reply its opponents, and the principle behind them cannot, and should not, be codified in law. Life is sacred and should not therefore be terminated by others, even on request.

And so the battle over one of the most complex, sensitive and fraught moral issues facing society rages on. This week, the House of Lords debated a select committee report on Lord Joffe's Assisted Dying for the Terminally Ill bill, an earlier version of the peer's forthcoming proposal. Under it, helping someone to end his life would become lawful, provided the patient was adult (over the age of 18), terminally ill (had only a few months left to live), mentally competent, was suffering unbearably and had made a written request for such assistance. In cases where the patient was not able on his own to administer the lethal dose, a doctor or nurse would be permitted to do so.

Since the 1961 Suicide Act, it is no longer a crime to commit suicide or attempt to do so. However, it remains unlawful, punishable by up to 14 years in prison, to "aid, abet, counsel or procure" a suicide. And deliberately taking the life of another person constitutes murder, even if the person is dying and has asked to be killed. A patient's refusal of treatment does not constitute suicide, which in law requires a "positive act". Nor is it murder if, to relieve pain, a doctor administers a drug that as a side effect shortens the patient's life—the "double-effect principle".

The last time Parliament picked its way through this moral mire was in 1994, when another House of Lords select committee decided not to change the law. It said you could not set limits on voluntary euthanasia (mercy-killing at the patient's request) to ensure that the law would not be abused. It foresaw a "slippery slope" in which mercy-killing slid ineluctably towards involuntary euthanasia. It was particularly worried that elderly, lonely, sick or distressed people would feel

pressure, whether real or imagined, to request help with an early death, fearing they were becoming a burden on their families.

The same concerns were voiced during this week's debate in the House of Lords. But much has changed over the past decade. Legislation to permit assisted suicide and/or voluntary euthanasia has been passed in the American state of Oregon, the Netherlands and Belgium (see article). "Right-to-die" groups in Switzerland, where assisted suicide has been lawful since 1942, have begun offering help to foreigners, including Britons. Public opinion, always sympathetic, has grown even more supportive; 87% of Britons now say they want the law changed to allow people to get medical help to die. Even the medical profession, although still divided, seems to have dropped its outright opposition.

Lord Joffe, an independent crossbencher, believes he now has a real chance of success. Both a first bill, introduced in 2003, and the more restrictive second bill, on which the select committee reported, ran out of time. The third bill, in accordance with the select committee's recommendations, will drop the provision for voluntary euthanasia, under which doctors would have been permitted to intervene directly to end a terminally ill patient's life. Only assisted suicide will now be made lawful, allowing the doctor to prescribe the lethal potion, but requiring the patient to administer it himself.

But this could have the unintended effect of inducing terminally ill patients to end their lives earlier, for fear that they may later no longer be capable of doing so. Two important categories of patients are excluded from all help: those who are not terminally ill, but are nevertheless suffering "unbearably" because of a chronic illness; and those who are no longer "medically competent" or able to communicate their wishes perhaps because they are in an irreversible coma after a road accident or because of dementia.

To those who protest at the "inequity" of the bill, Lord Joffe says he is adopting a step-by-step approach. This is only a "first stage", he says. Such comments serve to confirm the fears of those predicting a slippery slope. They draw a parallel with the 1967 Abortion Act (another private member's bill), under which the termination of a pregnancy was likewise supposed to be exceptional. Yet last year almost 200,000 abortions were carried out, nearly ten times more than in 1968. Reckonings based on experience in Oregon and the Netherlands suggest around 650 deaths a year could be expected from legalised assisted suicide, but as many as 13,000 a year from legalised voluntary euthanasia.

As with abortion, supporters of the legalisation argue that voluntary euthanasia already takes place covertly, so it would be better regulated. While surveys suggest that as many as one in seven doctors have helped patients to die at their request, the British Medical Association claims to have "no evidence whatever" of covert euthanasia. It suggests there is a confusion over the withdrawing and withholding of ineffective treatment and the provision of "double-effect" pain relief, both of which are lawful, and a deliberate act of euthanasia or assisted suicide, which is not.

Underlying the impassioned debate over Lord Joffe's bill is an age-old struggle. Which prevails: individual autonomy and freedom of choice of the most fundamental sort, or the view that human life is precious—and hence not for society to devalue as disposable and the individual to cast off? While the select committee was able to agree that in the interests of the wider community some limits should be set on patients' autonomy, it could reach no consensus on where those limits should be. The policeman's dilemma remains unresolved.

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Economist.com WORLD EUROPE

Euthanasia (2)

The art of dying

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The growing practice of euthanasia

THREE countries and one American state permit assisted suicide (where the lethal potion, prescribed by a doctor, is administered by the patient) or voluntary euthanasia (where a doctor—usually—administers the lethal dose).

Oregon permits only assisted suicide—the prescribing doctor cannot even be there when the patient takes the lethal potion, usually barbiturates. The patient must be adult, mentally competent, and "terminally ill"—having a life expectancy of six months of less. There is no requirement of "unbearable suffering". Two written requests for assistance must be made, separated by a 15-day interval.

Since the law came into force in 1997, just over 200 patients have received help in dying, about 0.1% of deaths in the state. The most common reason for wanting to hasten death was not pain, but anxiety over a loss of autonomy.

The Bush administration is challenging Oregon's law, saying it violates federal drug rules. Oregon has persuaded a federal district court and an appeals court that it is a matter for the states. But when the Supreme Court heard arguments in the case last week, it appeared divided. A ruling for Oregon could encourage other states to follow its lead.

The Netherlands allows voluntary euthanasia as well as assisted suicide. It is not limited to adults and the patient need not be terminally ill (though more than 95% are in their last few weeks). Only a doctor can assist the suicide or carry out the euthanasia. Two doctors must examine the patient, confirm his suffering is "lasting and unbearable" and be satisfied death is the best outcome.

Nearly 10,000 requests for euthanasia are made a year, of which some 3,800 are carried out. Although euthanasia should not happen without the patient's request, doctors admit to around 1,000 cases of this every year, bringing the total number of euthanasia and assisted suicide cases to 3-4% of all deaths. While high, this is no more than the number undergoing euthanasia before the practice became legal in 2002.

Belgium permits only voluntary euthanasia. The patient must be adult and in a "futile medical condition of constant and unbearable physical or mental suffering that cannot be alleviated". His request must be "voluntary, well considered, and repeated", and all this confirmed by two doctors. Last year, 347 acts of euthanasia were reported.

In **Switzerland** assisting suicide has been legal since 1942, provided it is not "self-serving"—designed to gain an inheritance, for example. There are three conditions: the patient must be nearing the end of his life; be mentally competent, free from external pressure, and have thought through his decision; and have considered alternatives. Of the couple of hundred annual cases of euthanasia in Switzerland, most are supervised by one of its "right-to-die" charities. One, Dignitas,

helps foreigners. Since being set up nearly eight years ago, it has helped 453 people to die, prompting Swiss fears of “suicide tourism”. Last month Dignitas courted controversy when it opened its first foreign branch in Germany, home to over half its clients.

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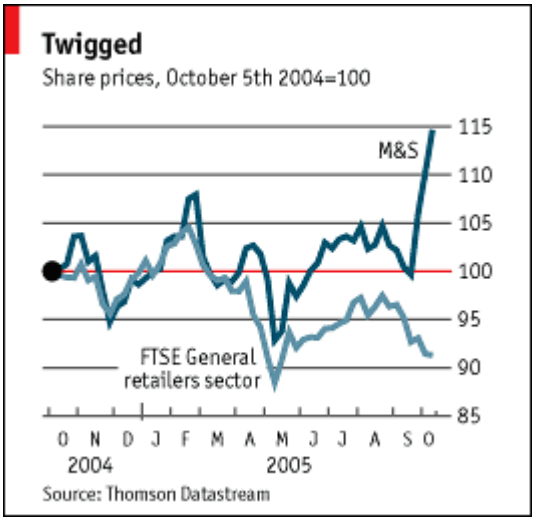
Economist.com WORLD EUROPE

Marks & Spencer

Financial fashion

Oct 13th 2005
From The Economist print edition

How to make a famous name acceptable again



MARKS & SPENCER'S fall from grace six years ago was as spectacular as it was rapid. In 1997 it became the first British retailer to make more than £1 billion in profits; by 2001 that had fallen to £146m. Complacent managers allowed its business to stagnate and fall far behind those of its rivals. Its worsening financial reputation, splashed across the newspapers, only aggravated its poor standing with customers.

Could that vicious circle now be about to reverse? This week M&S unveiled its best results for nearly two years. Sales rose 3.3% in the quarter to October—impressive in the midst of a retail slowdown. Its shares briefly touched £4—symbolic given that this was the offer price of a putative takeover bid. Newspapers swooned and analysts were upbeat: “I take my hat off to them,” said Richard Ratner, a long-time sceptic at Seymour Pierce, a stockbroker.

It is early days, of course: one good quarter does not make a recovery. But investors seem impressed: the firm's shares have handsomely outperformed the retail sector over the past few months (see chart). Much of the credit belongs to Stuart Rose, the chief executive hired in the throes of last year's takeover battle. He has revamped the company's antiquated supply chain, allowing it to compete with nimbler rivals like H&M and Next. He has cut costs and rationalised product ranges. Only the petulant resignation of George Davies, the founder of Per Una, an in-house fashion label, spoiled Mr Rose's day.

Winning back the loyalty of the British shopper will take plenty of old-fashioned graft. The firm is experimenting with store refurbishment and has launched a new advertising campaign featuring Twiggy, a 56-year-old model. It is meant to appeal to the middle-aged women that are the firm's main customers and which it has been accused of alienating in a misguided appeal to younger clientele.

But it may be that the exercise will gain a fillip from the business pages as its finances improve. Rita Clifton, the chairman of Interbrand, a consultancy, says that such coverage of a company is an important factor in how its customers perceive its brand. Bad news from the boardroom can make shoppers reluctant to patronise a company condemned as failing, despite their personal feelings towards it. “A few people in the media often have a big influence on perceptions of a brand,” she says. “M&S certainly has a bad reputation in the press. But it is a national icon, and there is still a lingering affection from the public.”

So it will be heartening for Mr Rose to note that hostility among hacks seems to be waning as his

reforms take effect. Coverage of the firm's results was positive despite the difficulties of drawing anything concrete from a single set of quarterly figures. Good things have been said about its latest range of clothes. “It's no longer seen as beyond the pale to shop there,” says Ms Clifton. “People feel like they have permission to go back in.”

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The BBC

Please, sir

Oct 13th 2005
From The Economist print edition

The BBC has asked for a lot more money

Get article background

YOU might think that because the BBC's share of audience is falling, Auntie could make do with less money, or at the very least get by without a big increase. Its 60-year-old method of funding—the licence fee, a flat tax on television sets—has come under attack from many quarters in the run-up to 2006, when its current funding runs out. But this week the BBC's director-general, Mark Thompson, amazed everyone by asking for a bigger rise than ever before.

This year each household that owns a television pays the BBC £126.50 for the privilege, thanks to its last agreement with the government, in 2000, which granted an annual rise of 1.5% above retail price inflation (RPI). For the next seven years, the BBC has asked for a real increase of 2.3% a year. Assuming an inflation rate of 2.0%, that could mean a licence fee of more than £170 by 2013.

Part of the extra money will be spent on improving its programming, which makes sense, since the BBC dumbed down under its former director-general, Greg Dyke. But the Beeb will also spend lots more on digital services and moving into local markets, areas which draw loud complaints from commercial competitors. Some £2.6 billion of the extra £5.5 billion the BBC wants will come from its own cost savings (though that is licence-payers' money, too).

Another piece of expenditure—£500m—will go on the government's project to switch the country from analogue to digital television in 2012. Including part of the cost of switchover in the BBC's budget means that the government is funding its industrial policy by means of a regressive tax on licence-fee payers rather than raising income tax.

The Treasury may well refuse the BBC's proposal, even though the Department for Culture, Media and Sport is thought to support it in principle. Conservative MPs, who have been surprisingly quiet on the BBC's funding for the past year or so, went on the attack this week. Nigel Evans, vice-chairman of the Conservative Party, said the increases risked creating “licence-fee martyrs”.

The BBC pointed out that research from MORI shows that four-fifths of its audience thinks the licence fee is good value, and more than two-fifths would willingly pay at least twice as much. That the BBC should defend itself with the second figure shows scant regard for the poorest viewers. Ofcom, the regulator, has found that nearly 60% of people from “AB” or affluent professional households support the idea of the licence fee, but only 35% of “DE” homes do. Perhaps, for once, the pollsters should ask the obvious question: would you like to pay less for your TV licence?

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Economist.com WORLD EUROPE

Economic prospects

Nasty awakening...

Oct 13th 2005
From The Economist print edition

...after a nice decade

Get article background

IN HIS first speech after becoming governor of the Bank of England in 2003, Mervyn King dubbed the period since 1992 as the nice—non-inflationary consistently expansionary—decade. In a speech on October 11th, he said it was unlikely that the next ten years would be so pleasant.

There are immediate worries about both inflation and growth. Inflation has risen over the past year from 1.1% to 2.4%. Growth has slowed to 1.5%, its lowest for 12 years. Mr King said that the Bank's interest-rate-setting committee had been surprised by both the economic slowdown and the rate at which inflation had picked up.

No more than half of the acceleration in inflation could be ascribed to higher oil prices, the governor argued. There were broader inflationary pressures from an economy operating close to its capacity. Furthermore, the rise in oil prices would dent capacity growth by making some capital equipment unprofitable to use. Such remarks suggested that Mr King, who voted against the cut in interest rates in August, is likely to oppose a further reduction in November.

Mr King's hawkish stance was backed a day later by the OECD which said there was “not a compelling case for further rate cuts”. Although it is now forecasting growth of only 1.7% this year, the OECD said in an economic survey of Britain that the level of output was close to capacity. It also gave warning that tax rises were needed for the government to meet its fiscal rules.

The OECD pinpointed a number of structural flaws that are likely to hold back the economy in the longer term. Low productivity remains its Achilles heel, with no clear signs of any recent pick-up in its trend growth. As a result, Britain remains stuck behind other countries such as France and America in GDP per hour worked.

Poor skills contribute to the productivity gap. Compared with most other advanced countries, British workers are poorly educated. This may help to explain why investments in information technology have failed to push up productivity growth, unlike in America.

Another brake on productivity growth is poor transport infrastructure. But the OECD reserves its fiercest criticism for Britain's record on innovation which it describes as “mediocre”. Across a range of indicators, including R&D spending, patenting and the employment of scientists and researchers, Britain scores badly compared with top-performing countries.

The report also highlights the worryingly high level of people on incapacity benefits. The share of prime-age (25-54) men who are inactive because of illness and disability is the highest among OECD countries.

The government is striving to tackle these weaknesses, but its efforts do not seem to have worked so far. Indeed Labour has harmed the supply side of the economy by increasing the regulatory and pension burden on companies. As a result, both the economy's short-term and longer-term prospects are far from nice.

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University admissions

Eeny meeny miney mo

Oct 13th 2005
From The Economist print edition

There must be a better way to fill universities

Get article background

ADMISSIONS tutors at top-ranked British universities do difficult and thankless work. Each year they must choose from among hordes of applicants, all predicted to get straight As at A-level, and all with personal statements and references proclaiming them to be motivated, diligent and full of promise.

So in an attempt to get more information than can be gleaned from A-levels alone, universities are increasingly requiring school-leavers to take supplementary tests. Potential Cambridge maths students must sit three extra papers, some Cambridge colleges use a Thinking Skills Assessment to help select scientists and engineers, and a number of the most selective universities require aspiring doctors, vets and lawyers to take special subject tests.

The enormous increase in the number of students with high grades is not the only reason for this proliferation of tests. If it were, the problem could be dealt with simply by making A-levels harder. Universities are also trying to find ways of discovering hidden talents in students who have been poorly taught at school. Not only is it in their interests, but they are also under pressure from the government to admit more applicants from state schools. From this point of view, the problem with A-levels is that students of equal ability get better A-level results at expensive private schools than they do at state schools: one study estimated that going private buys, on average, an extra grade in each subject.

Last month the university admissions service said that from 2007 it will provide universities with separate grades for each A-level module, rather than a single overall subject grade. Universities may find it difficult to use this extra information: anything that provides better differentiation in A-level results at the top end is likely to widen the gap between state and independently educated students still more.

So the race is on to find a single test that can identify badly taught students with potential. One candidate being developed by Cambridge Assessment, an educational testing company, is uniTEST. But the government has been persuaded by the Sutton Trust, an education charity, to help fund a trial of another candidate, the American Scholastic Aptitude Test (SAT). Over the next five years, 50,000 school-leavers will take the SAT. Their results will not be used to select for university courses; instead they will be compared with eventual degree results to see if they are a better predictor of success than A-levels are.

It is not immediately obvious that the SAT is worth looking at. A large study in the 1960s and 1970s in which school-leavers took a Test of Academic Aptitude (TAA), modelled on the SAT, concluded that A-levels were much better at predicting degree results and that taking TAA results into consideration improved the prediction hardly at all.

But it may be worth giving SATs another try. Back when the study was done, most university students had been to academically selective schools, whether private or state, and the sort of students the government now wants to encourage were weeded out at the age of 11. These days most state-educated pupils taking A-levels have never faced any selection; only the privately educated ones have. The theory is that in those days A-levels used to say more about ability because they used to say so much less about where a student had been to school.

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Economist.com WORLD EUROPE

Bagehot

Can the Tories become the nice party?

Oct 13th 2005
From The Economist print edition

If the Tories want to be liked, they will pick David Cameron

Get article background

DOWNING STREET is not quite sure what to make of the astonishing rise of David Cameron. A grizzled prime ministerial adviser remarked this week that it had happened so fast it was difficult to take entirely seriously.

He contrasted the excitement Mr Cameron's leadership campaign has generated, thanks to a well handled press launch and a polished conference speech, with the real policy battles that Tony Blair, as a rising frontbench spokesman of similar age, fought over several years to make his party electable. He also doubted whether the Conservative Party's sudden enthusiasm for Mr Cameron came close to matching Labour's commitment to change in the early 1990s.

These are fair points, but they may also miss the point. Mr Blair had opportunities to challenge his party that Mr Cameron, in his absurdly brief career as an MP and before that as a political adviser, has not. But then Labour also had more policies that it needed to discard before it could stand any chance of being elected. The greatest problem for the Tories is not their policies—although some of those they took into the last election were either intellectually unconvincing or unpleasantly opportunistic—but the electorate's overall perception of them as being grumpy, pessimistic and out of touch.

Whereas Labour had to show it was competent, the task for the Tories, which is in some ways more difficult, is to show they are decent. The lesson they must take to heart is an opinion-poll finding, cited by Francis Maude, the party chairman, in his speech to the party conference last week, that just sticking the Tory brand on a policy made it unpopular. Focus-group evidence

during the election suggested something very similar. At the outset of the campaign, some women in Watford, interviewed by a market research firm for the BBC, identified immigration as the issue that caused them most concern. But by the end of the campaign, most of them had decided not to vote Conservative. One reason was that they found the party's tough rhetoric on immigration unpleasant and embarrassing.

Mr Cameron, alone among the leadership candidates, offers an answer to his party's predicament. Tory activists spotted this much more quickly than did the MPs, who worry about his inexperience and are prone to understandable envy about the preferment that has assisted his rise. Consequently, David Davis is still likely to secure a good few more votes than Mr Cameron in the first round of voting at Westminster next Tuesday (the second round follows two days later). But as long as Mr Cameron makes it through to the final duo from which the grassroots members will make their choice, then, barring some disastrous gaffe or revelation about his earlier life, he should walk it.

Of all the many polls that have been published over the past week, the most significant was a survey (by YouGov in the *Sunday Times*) of the voting intentions of party members. On the basis of their performances last week in Blackpool, YouGov found that 39% of members wanted Mr Cameron as leader compared with 26% for Ken Clarke and just 14% for Mr Davis. When asked who they thought would do most to boost the Tories' chances of winning the next election, Mr Cameron beat Mr Davis by 38% to 11%. If the party members' ballot is between Mr Cameron and Mr Davis, the vote would split 66% to 27% in the younger man's favour. Ominously for Mr Davis, YouGov was highly accurate in predicting the outcome of the contest in 2001 between Mr Clarke and Iain Duncan Smith.

Given that there are only marginal distinctions between the policies Mr Cameron and Mr Davis would be likely to pursue, what is the explanation for this? Mr Cameron hints that he would spend a little bit more of the fruits of growth on public services and a bit less on tax cuts, he would be less inclined to strike belligerent poses over Europe, although he is just as hostile to the euro, and would be more liberal on some social issues. That makes him a bit more centrist than Mr Davis, but there is not really all that much to choose between them.

The likeable lad

Part of the answer is that Mr Cameron is the only leadership candidate to have come to terms with Blairism. He realises the extent to which Mr Blair has squeezed the ideological space available for the Conservatives to differentiate themselves, and how the prime minister's use of charm and reason has made the traditional dialectic of British politics seem oddly dated. He sees Mr Blair's eventual departure from the scene not so much as a chance to seize his legacy, as one to convince voters they can have what was good about him without the bad bits, not least his foot-dragging party and obstructive chancellor.

New Labour was forced to offer an ameliorated version of the Thatcher economic approach. Now the Conservatives have to make their accommodation with the Blair agenda of reforming and investing in public services by promising to improve on it and finish the job.

The other part of the answer is that while Mr Davis talks about change, Mr Cameron embodies it. When Mr Cameron says that, unlike his main rival and his three predecessors, he would not be terrorised into resorting to right-wing tactics by a run of gloomy polls and bullying Tory newspapers, you believe him. That's because unlike them he does not seem to be trying to be something he is not.

But most of all, the reason for Mr Cameron's success over the last fortnight is that people who

have seen something of him for the first time quickly take to him—just as they once did to Mr Blair—because he is charming, passionate, persuasive and a bit waffly. Is there a risk in making him leader too soon? Absolutely. But with Mr Cameron there is a prize no other candidate can offer: the chance for the Tories to be liked.

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Time Warner

Wolf at the door

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Pressure from Carl Icahn and other shareholders is just what Time Warner needs

Get article background

FOR a short time this summer, Time Warner, the biggest media company in the world, thought it had moved on from its disastrous takeover in 2000 by AOL, an internet firm. In August it set aside $3 billion to settle legal claims over the merger. With that its managers expected to be left alone to concentrate on developing the company's assets, which include movie studios, cable-television channels, a cable system and magazines, as well as AOL. But now the company has to fend off Carl Icahn, a billionaire corporate raider. In August Mr Icahn announced he had taken a stake in Time Warner, alongside some hedge funds. This week he got personal. On October 11th in a long letter to shareholders he attacked the company's management and board members.

Even while Mr Icahn is circling, Time Warner's managers are receiving more- welcome overtures from two giants of the internet world—Google and the MSN division of Microsoft. The two companies are reported to be competing to take a stake in AOL, as a way of scooping up internet users. Any such deal might generate some cash to help appease Mr Icahn. But it would not address the corporate raider's broader critique of the company.

Mr Icahn initially said that Time Warner should sell its cable division, which in 2004 accounted for a fifth of revenues, and use the money to buy back $20 billion worth of its own shares. That would quickly narrow the gap between the price of Time Warner's shares and the potential value of its assets, he said. Before he made his demands the firm had already announced plans to buy back $5 billion of its shares and spin off 16% of its cable operation. With a total market capitalisation of

$82 billion, the firm is still the world's largest media company. But at around $18, the company's share price has fallen by a total of 76% since before its merger with AOL. Dick Parsons became chief executive in May 2002 and started trying to repair the damage. But the share price has still fallen by 5% since he took over.

This week Mr Icahn accused the firm's top managers of “paralysis of inaction” and argued that they have sold assets far too cheaply since the merger. In 2002 the company was heavily in debt and needed cash. Mr Parsons sold Warner Music to private-equity investors for $2.6 billion. Mr Icahn points out that Warner Music, which was floated on the stockmarket this year, is now worth $4.7 billion. Time Warner's board, he complains, still contains most of the Time Warner members who made the terrible decision to sell the company to AOL, as well as former AOL board directors. Time Warner's new headquarters at Columbus Circle in Manhattan are excessively lavish, he complains.

Much of what Mr Icahn says is right. It is true that the company has sold assets for prices that were far too low—at least with the benefit of hindsight. Many of the firm's top managers must surely resent the continued presence on the board of Steve Case, the man who wooed them into one of the worst mergers in history. And Time Warner's corporate culture is certainly not known for leanness.

With his allies, however, Mr Icahn controls only 2.8% of Time Warner's shares. Although it has no controlling shareholder like News Corporation or Viacom, two other giant media conglomerates, the company's fragmented shareholder base (the biggest owns 5.3%) gives it protection. That means Mr Icahn would have to muster support from other shareholders if he wanted, for instance, to try and oust management. He is highly unlikely to get backing for anything so drastic. Other institutional fund managers distrust him as a short-term investor, and Time Warner's top managers have kept on good terms with shareholders, despite the company's lagging share price.

Time Raider 2

Shareholders are nevertheless very happy to use Mr Icahn as a spur to get the firm's top managers to think more aggressively about how to increase its share price. Mr Icahn has spoken to fellow shareholders, says Jessica Reif Cohen, the media analyst at Merrill Lynch, and his letter this week is in effect “a collection of their individual miseries.” His demand that Time Warner buy back more shares especially strikes a chord with other investors. Big traditional media firms are finding it hard to grow, and their record on mergers and acquisitions has been poor. So many of them are under pressure to return money to shareholders.

Mr Parsons' response is that Time Warner will increase its share buyback and possibly spin off more of its cable concerns. He also argues that it is AOL that will drive the firm's share price in the immediate future, more than share buybacks or cable. The attentions of Google (in alliance with Comcast, a big cable television company) and Microsoft certainly suggest that AOL is far from moribund. It contributed a fifth of Time Warner's revenues last year, mostly from selling premium dial-up access to the internet. But the dial-up business has been in decline for years because people are shifting to broadband web access. So the new strategy is to diversify away from subscription towards internet advertising. This summer it launched a portal, AOL.com, to attract more visitors and ad revenue, offering free content previously reserved for AOL subscribers.

So far the strategy seems to be working: ad revenue is growing quickly and in July millions of people tuned in to AOL.com for a webcast of the Live 8 concerts. “We're not far off Yahoo! for number of visitors,” says Don Logan, who oversees AOL for Time Warner, “but we're not getting recognition from Wall Street yet.” A link-up with either Microsoft or Google would secure more traffic and advertising for AOL, as well as a big cash infusion for the company that might be

handed back to shareholders.

“We're asking ourselves whether we have all the partnerships we need to grow in online advertising and we're exploring all our options,” says Mr Parsons. But the problem with AOL, says Michael Nathanson, an analyst at Sanford Bernstein, is that its declining subscriber business still accounts for far more of its revenues than its growing advertising business.

Many shareholders, Mr Icahn included, are also worried about Time Warner's cable business. Once Time Warner completes its acquisition of Adelphia, a bankrupt cable operator with a valuable franchise, roughly half of Time Warner's profits will come from this division. The industry faces new competition from phone companies, which will soon offer video products as well as voice and broadband, and a price war could ruin profitability. For the moment, Mr Parsons says that cable is still an excellent business, and that Time Warner's content assets benefit from having distribution to back them up.

Changes in Time Warner's management are on the way. Mr Parsons was appointed to clear up after the merger. He is a conservative lawyer and banker, who unlike other top executives at Time Warner has not built a media business. Under Mr Parsons, says Peter Kreisky, chairman of the Kreisky Media Consultancy, “there's an appropriate sense of steady-as-she-goes.” His successor, in the next few years, is expected to be Jeffrey Bewkes, the man who built Time Warner's crown jewel, HBO, a cable-television company. Mr Bewkes has more appetite for risk, and next year could take over management of AOL, Time Warner Cable and the magazine division from Mr Logan, who is expected to retire. At some point in the next few years Mr Bewkes will probably become CEO—a change which could help drive the company forward.

For now, all Mr Icahn wants is a new, independent shareholder representative on Time Warner's board, which could be himself or someone else. It is hard to see how that could do anything but help the firm make rigorous decisions on what businesses to be in for the long term.

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Microsoft

The enemy of my enemy...

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By making up with old foes, Microsoft strengthens its hand against new ones

BOTH of Microsoft's deals with rival firms this week are classic cases of “the enemy of my enemy is my friend”. On October 11th, the world's biggest software company announced that it had settled its long-running dispute with RealNetworks, a maker of media-playback software. The following day it announced a deal with Yahoo!, a big internet portal, to link up the two firms' rival instant-messaging systems. Evidently Microsoft has concluded that co-operating with old foes will help it compete better against new ones.

Real launched an antitrust action against Microsoft in 2003, demanding $1 billion in compensation for Microsoft's use of its Windows monopoly to promote its own media-playback software at the expense of Real's rival product. It was also a strong supporter of legal action against Microsoft by trustbusters in Europe and Asia. Under the terms of this week's deal, Microsoft will pay Real $460m to drop its claims, plus a further $301m over the next 18 months.

The two firms will promote each other's products. Users who search for music-related terms on Microsoft's MSN portal will be directed to Real's Rhapsody music service; MSN search will be incorporated into Real's playback software (take that, Google); and users of Microsoft's instant-messaging service will be able to play music from Rhapsody while chatting. The two firms will also co-operate on security formats used to protect music downloads—for having been rivals in media-playback software, they are now on the same side of the digital-music battle against Apple, the market leader.

A similar logic underpins Microsoft's deal with Yahoo!, which will link up the second and third-largest instant-messaging networks. This will put pressure on AOL, the market leader, to open up its rival service. Just as importantly, it provides a riposte to Google, which recently launched its own service, making much of its openness—and which now holds the title of Microsoft's arch-rival.

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Economist.com BUSINESS

Business airlines

Battle of the Atlantic

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Two new carriers enter the fray

FOR an industry still losing billions, especially in America, aviation is showing surprising signs of life. Not only has the low-cost model spread from America through Europe to Asia, but new niche carriers are emerging in traditional markets.

Two notable ones start flying between London and New York in the next couple of weeks. Unlike previous stillborn start-ups on that route, Eos (a dedicated luxury business carrier) and Maxjet (a low-fare variant) both have plenty of finance, and pretty clear ideas of what market they aim to tap. Both are based on point-to-point services, with costs held down by avoiding costly hub connection services.

Eos is the brainchild of David Spurlock, formerly a top manager at British Airways and architect of its strategy of trimming capacity to concentrate on rich passengers. He has raised $87m, mainly from private-equity funds in Silicon Valley. American capital is also behind Maxjet. Mr Spurlock believes the day of the “all things to all men” carrier are numbered, and that the future lies with niche airlines operating simple route networks.

Eos has three second-hand Boeing 757s, originally built to carry up to 250 passengers. Mr Spurlock has ripped out the interiors and thrown out 200 seats to cater for 48 business travellers in an environment that more closely resembles a corporate jet than a business-class cabin. For instance, he claims that passengers will have up to one-third more floor area than on Virgin Upper Class—and a staggered seat layout that will allow more privacy than in anywhere but first class. Starting on October 18th, daily flights will leave London Stansted in the morning, returning from New York's JFK overnight. Two flights each way are planned from January, with return fares of around $6,500.

Maxjet aims at another bit of the business market. It was originally conceived as a long-haul, low-cost airline, before its chief executive Gary Rogliano realised he could not compete with the special deals mainstream carriers such as British Airways offer leisure travellers. So he changed his plans. His wide-bodied Boeing 767s will carry 102 passengers (half their original capacity), with double the space per seat, for a return fare around full economy levels, at just over $1,600. He is counting on budget-conscious business passengers flying into Stansted on low-fare carriers to take advantage of his blend of extra comfort and standard fares across the Atlantic.

The new carriers will add about 25% to the business-class capacity British Airways already offers on the route with its ten daily flights to New York. But BA will be fighting back with its own £100m investment in a new business cabin, which is being phased in from January. Transatlantic travelers may have lost the glitz and speed of Concorde, but they are being offered the luxury of more choice and competition at the more modest end of the market.

China's gold rush

Cracking the vault

Oct 13th 2005 | LAIZHOU
From The Economist print edition

Foreign investors enter the Chinese gold market

Get article background

THERE has been no shortage over the past two decades of would-be foreign gold diggers rushing into China in search of treasure. But for most of that time China's gold industry itself was off limits to outsiders, with mining and refining controlled by parochial and xenophobic state officials. Indeed, much of China's gold production was traditionally shrouded in secrecy and managed by the military. Now, foreign operators are finally getting a foot in the vault. And an enticing place it is. Gold prices continue to soar and China is the world's fourth-largest producer, with output rising 5.9% last year.

Among the foreign “operators” are billions of bacteria slaving away in 12 metre-tall vats of roiling black gloop at the BioGold refinery in the Shandong gold-mining town of Laizhou. Brought in by Michelago, an Australian mining firm, the bacteria reproduce like mad while consuming the sulphur and arsenic present in refractory ore. These industrious bugs help winnow each tonne of dull ore down to 50 grams of shiny gold, which the plant, a joint venture between Michelago and the Shandong Tarzan Mining Co, sells on the Shanghai Gold Exchange.

The establishment of that exchange, less than three years ago, was the first step in opening China's gold sector, and was followed by lifting controls on private domestic gold consumption, and a gradual—but so far partial—easing of restrictions on foreign participation in exploration, mining and refining. Gold export restrictions remain, but domestic demand looks like staying strong. Chinese consumption grew 13% last year to 234 tonnes, well above the 212 tonnes produced domestically. But China's annual per person consumption is only 0.16 grams, less than a quarter of the world average.

Together with a handful of Canadian and other Australian firms now working in China, Michelago sees immense opportunity, especially because of high fragmentation and low efficiency among Chinese producers. The government says a quarter of China's 4,000 tonnes of deposits cannot be exploited without foreign technologies. All but 100 of China's 1,200 gold mines produce less than 500 kilograms annually and Michelago thinks that average production per enterprise is less than a third that amount.

It is the smaller producers that interest foreign investors most, since they lack the scale to refine efficiently themselves. Michelago also thinks that foreigners could benefit from the fact that around two-thirds of Chinese gold ore is high in sulphur and arsenic content. Traditional heat-roasting techniques are highly polluting, and as Chinese environmental regulations become more rigorous, the competitive advantage of cleaner foreign operators only grows. That trend is most pronounced in prosperous coastal areas like Shandong. The province has already shut most of its roasters, meaning Australian bacteria should have ample opportunity to keep reproducing—and reaping gold—in China.

Economist.com BUSINESS

Intellectual property

Free ideas

Oct 13th 2005
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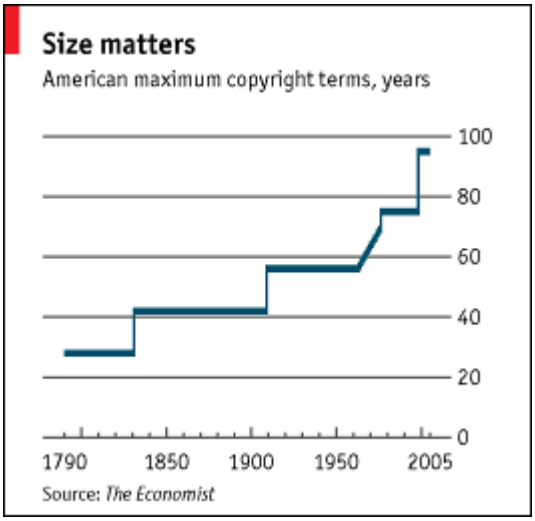
An initiative to reverse the proliferation of patents and copyrights



PATENTS and copyright laws are meant to be the friends of innovation and are a foundation of the modern business world. But there is a growing risk that intellectual-property laws are now so stringent that they are actually inhibiting innovation, rather than protecting it.

The call for a new approach was made forcefully this week in a statement called the Adelphi Charter, issued by a group of prominent legal scholars, artists, scientists and experts from around the world. The Adelphi group are a varied crew ranging from Gilberto Gil, the Brazilian culture minister (and pop star) to Sir John Sulston, a Nobel-winning scientist who helped decode the human genome, and James Boyle, a law professor at Duke University. They believe that the intellectual-property system is starting to lean so far in favour of private enrichment that it no longer serves the public interest. For example, two hundred years ago, copyright lasted 28 years. It then began to increase and, in the 20th century, lawmakers roughly doubled its length in America and many other countries with little public debate or economic rationale. Organised by Britain's Royal Society for the encouragement of Arts, Manufactures & Commerce, the group hopes the 453-word charter will help restore balance.

The charter lays out a “public-interest test” for policymakers to use before changing intellectual property laws: an automatic presumption against expanding rights, placing the burden of proof on those who seek this, as well as requiring rigorous analysis to justify changes, along with broad public consultation.

This is a good approach, and yet the Adelphi principles leave important questions hanging in the air. The charter declares that software, business processes, and medical therapies should not be patented, nor copyright extended to things like databases that are simply compilations of open facts. But the Adelphites have not submitted these ideas to the same kind of rigorous economic analysis that they demand from their foes.

What is clear is that, as technologies like computers and the internet make the exchange of information easier than ever—and inventions become more conceptual—huge stress is being placed on today's intellectual-property laws, which trace their foundations to the birth of the printing industry and mechanical industrialisation.

Industries that rely on copyright and patent protection are increasingly turning to the law to protect their businesses. For example, music firms are suing thousands of people for swapping

songs online and trying to stem the tide of counterfeit CDs. Google has also recently been sued by a trade association of authors to prevent it from placing book excerpts online. And Microsoft has recently reiterated its intention to patent a basic format for storing files—a move that could let the firm collect money from the IT industry for things that have been done cost-free for years. Meanwhile, the World Intellectual Property Organisation, a United Nations body, is pushing ahead with treaty negotiations that will create a new layer of rights for broadcasters, including on the web.

At the same time, new approaches aim to work around overly-restrictive rights, such as the open-source software movement and an effort called the Creative Commons, which makes it easy for creators to give away some of their copyrights under licence while retaining others to control how their works are reused.

The Adelphi Charter is clearly far from a complete answer to the dilemmas posed by intellectual-property rights in an era shaped by digital technology and the desire for as much innovation as possible. But it does aim at the right target by promoting the idea that—as Mr Boyle puts it—“good policy does not just consist of ‘more rights', it consists of maintaining a balance between the realm of property and the realm of the public domain”.

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Economist.com BUSINESS

French corporate governance

All in the family

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How Accor lost one potential boss and found another

AP

A smiling nephew

AS THE largest hotel group in Europe, and the fourth-largest in the world, Accor makes its money from opening its doors to all comers. But when it comes to the management of the company, it looks as if only the well-connected need apply. On October 10th Gilles Pélisson was unanimously chosen by members of the group's supervisory board to take over as chief executive of Accor next January. He was the only candidate. The result was highly satisfactory for Gérard Pélisson, one of the co-founders of Accor, since Gilles is his nephew and heir.

If the outcome looked neat, the process of getting there was anything but tidy. Accor's governance crisis started a few months ago when rumours emerged in the press that Jean-Marc Espalioux, who has run the company since 1997, was on his way out. There was no obvious reason to replace Mr Espalioux. He has done a good job steering Accor through the recent crisis in the tourism industry. On September 7th, the group, which owns hotels ranging from the luxury Sofitel brand to the American-based Motel 6 chain, reported that net profit for the first half of the year had more than doubled to €156m ($200m) from €64m in the same period last year. It made public plans to open about 200 new hotels this year and 1,000 hotels by 2009. But on the same day it announced that Mr Espalioux would not spearhead Accor's “new phase of development”.

To make sure the selection of the new boss was impartial, the big French banks represented on the company's supervisory board insisted that Accor hire Russell Reynolds, a headhunter. After a short search, the headhunters recommended Pierre Danon, chief operating officer of Capgemini, an IT services company. Although he had only recently joined Capgemini, Mr Danon was tempted by the high-profile Accor job. But somebody told Serge Kampf, the chairman of Capgemini, that Mr Danon was talking to Accor—and Mr Kampf then fired Mr Danon. The unfortunate Mr Danon then also quit the race for the top job at Accor.

Enraged by the loss of their favoured candidate, the banks represented on the Accor board said in a public statement on October 6th that they could not support the replacement process any more. A spokesman for Société Générale, one of the three major shareholders in Accor, says that the banks felt that the whole appointment process had been undermined by constant leaks to the press. It was only when Gérard Pélisson and his co-founder Paul Dubrule agreed to step down from the supervisory board—and a switch to a new management structure was agreed—that Accor's major shareholders were mollified and agreed to the appointment of Pélisson junior as chief executive.

The irony is that, even without his family name and his uncle's support, Gilles Pélisson would have

been a perfectly plausible candidate to take over as boss of Accor. A graduate of Harvard Business School, he had already worked for 12 years at Accor. He has done well in his current job as boss of Bouygues Telecom, the telecoms arm of Bouygues, a construction group. But as it is, he is taking over as boss of Accor with his credibility inevitably damaged.

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Economist.com BUSINESS

Face value

The master builder

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How Lorenzo Zambrano built a global leader from modest origins in Mexico

Landov

THE Spanish conquistadors scoured Mexico looking for cities made of gold. But they were looking in the wrong place. The hills of central Mexico, outside the city of Puebla, are indeed filled with potential wealth—but of a rather less glamorous sort. One need only grind the limestone the hills are made of down to a fine grit, mix it with clay and gypsum at high temperatures, put the result in bags, and sell it. At Tepeaca, the western hemisphere's largest cement plant, Cemex, a Mexican cement firm, does just this, grinding out 7,200 tonnes a day.

Lorenzo Zambrano, the boss of Cemex since 1985, has built up his company from a middle-sized cement company—not even the largest in Mexico when he took over—to a world powerhouse with operations in more than 50 countries. Last year Cemex bought the RMC Group, a British cement firm, for $5.8 billion. The purchase turned Cemex into the largest producer of ready-mix cement (the stuff one sees tumbling around in trucks, ready to be poured) in the world. Along with Lafarge of France and Holcim of Switzerland, it is part of a triumvirate of companies that now dominates the global cement market.

This kind of prominence is highly unusual for a Mexican firm. Other Mexican companies have presences abroad—Bimbo, a breadmaker, peddles its slices elsewhere in Latin America, and Carlos Slim, Mexico's richest man and helmsman of Téléfonos de Mexico, the country's telecoms incumbent, owns companies in the United States, such as CompUSA, a computer retailer. But what distinguishes Mr Zambrano from Mr Slim and other Mexican tycoons is that he has not merely used a fortune built up in Mexico to make investments elsewhere, but has developed a Mexican firm into a world leader. Mexico is no longer even Cemex's most important market. Although early on Cemex took advantage of its pricing power in Mexico, from the beginning Mr Zambrano had a focus on accountability and efficiency that led him naturally beyond Mexico's borders. The lessons for other entrepreneurs in middle-income countries, such as India or Brazil,

are clear—in the long run, good management will serve much better than crony capitalism. Nonetheless, it is striking how few chief executives have managed to pull off Mr Zambrano's trick of turning a small company in a poor country into a big company in many rich countries.

Mr Zambrano himself blends the technocrat with the aristocrat. Though Cemex was founded in 1906 by his grandfather and the Zambrano family still owns a substantial chunk of the stock, he worked at the company for 18 years before taking the top job. He now presides over Cemex not from a top-floor suite, but from a relatively modest office on the ground floor. His subordinates credit him not only with strategic vision, but also with a hand in day-to-day operations. Although he sits on the board of IBM and advises both Citigroup and DaimlerChrysler, Cemex's success may stem in large part from his refusal to diversify into other industries at a time in the late 1980s when this was the norm for rich Mexicans. Instead Mr Zambrano stuck to an industry that he knew and built up his company through a series of carefully considered strategic acquisitions.

Within four years of taking over, he bought two of Cemex's biggest Mexican competitors. He then bought companies in Spain and around Latin America. In 2000, Cemex acquired Southdown, an American cement company, and became the largest producer in North America. The purchase of Britain's RMC Group has now given Cemex a strong presence across Europe. Developing new markets—both geographically and in terms of products—has been central to Cemex's strategy. Before buying RMC, Cemex's production was skewed towards plain cement, which is sold dry in bags. The acquisition of RMC added new expertise in ready-mix cement, which was important as more large-scale construction projects were beginning to be undertaken in Mexico, and Cemex's international competitors began to muscle in on the company's domestic market. Lafarge is building a new plant not far from Tepeaca, while Holcim is expanding sales fast in Mexico.

The North American way

Though Cemex's headquarters, in the northern city of Monterrey, Mexico's third-largest, are physically in Mexico, spiritually they are part of a broader North American business culture. The company's official language is English. Most of its executives are, like Mr Zambrano, graduates of Monterrey Tech, often described as Mexico's MIT.

Indeed, the company prides itself on improving the management of the companies it takes over. The large cement plant at Rugby, in England, that is now part of the Cemex empire, was notoriously bug-ridden under its old owners—often running at only 70% of capacity. Within two months of the Cemex takeover, it was up to 93%. Mr Zambrano attributes the change to the implementation of the “Cemex way”. This is MBA-speak (Stanford, in Mr Zambrano's case) for a highly centralised, yet flexible model. Cemex's plants around the world are monitored from a Star Trek-like computer facility in Monterrey. But remote monitoring will not let a plant run with fewer stoppages. This was accomplished largely by the simple measure of turning off all non-essential alarms—increasing efficiency without, it is claimed, compromising safety.

Just as a cement plant can incorporate nearly anything burnable into cement, Mr Zambrano seems to have a limitless capacity to subsume companies into Cemex, from Indonesia to England. The only noticeable gaps are in both India and China—where analysts point to Cemex's small presence as a weakness, but Mr Zambrano insists he sees potential growth. Nonetheless, he says that his goal is not to run the world's biggest cement company, but the best. At this rate, he may end up doing both.

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Economist.com BUSINESS

Corporate America's legacy costs

Now for the reckoning

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Retirement benefits promised to employees are becoming a crippling burden for a growing number of firms, especially in America

Getty Images

YOU didn't need an oracle to know that Delphi would end up in America's bankruptcy courts, which is where it sought protection from its creditors on October 8th. The world's biggest maker of car parts has been crushed not least by the legacy of generous pension and health-care promises made in the past to its American employees. Despite Delphi's annual revenues of $28 billion, in a market increasingly served by low-cost workers in places like China and with raw-material costs soaring these benefits are no longer affordable. Delphi's future pension obligations alone are valued at $8.5 billion. Some $4.3 billion of that is “unfunded”—ie, the firm has failed to put aside enough money to meet its obligations. Its unfunded health-care promises are even larger.

Delphi's bankruptcy may have painful consequences for its workers and retirees, who, under Chapter 11 of America's bankruptcy code, could see their benefits slashed as the company restructures its liabilities in the hope of becoming profitable again. The bankruptcy will also affect General Motors (GM), the world's biggest carmaker, from which Delphi was spun off in 1999. Having declined to rescue Delphi, GM faces disruption to its supply chain. It might also have to honour guarantees it made in the event that Delphi ever came under “financial distress”—that presumably encompasses bankruptcy.

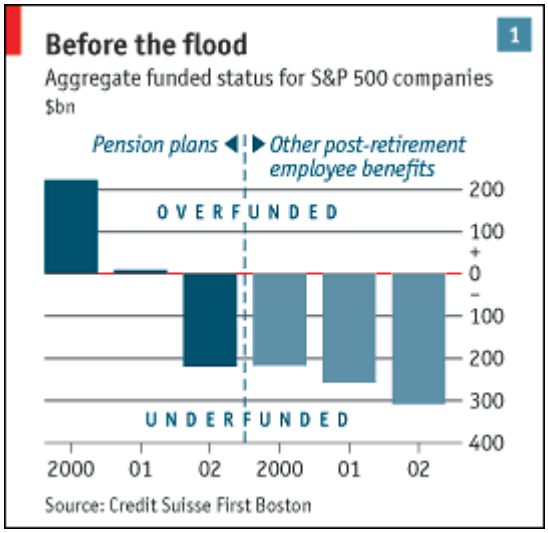
Estimates of GM's potential liability to Delphi range from $1.5 billion to $11 billion. Alas for the carmaker, such numbers are dwarfed by its own existing pension and health-care burden, now so large that there is increasingly talk in Detroit that it too may be driven into bankruptcy. Steve Miller, Delphi's boss and a veteran of bankruptcy wrangles in other industries, predicted this week that GM would go bust inside the next three years unless it can win huge concessions from its

trade unions—something Delphi failed to do.

The numbers are awful. GM's credit rating was lowered again by Standard & Poor's on October 10th. GM expects to spend over $5 billion this year on health care alone, up by $1 billion since last year. That adds up to about $1,500 for each car made by GM, or some 3% of the firm's revenues. Much of this money is for GM's former workers: it now provides health insurance to over 1m retired Americans.

GM says that its current pension-fund liabilities are fully funded, but that claim is controversial. Outsiders think that the firm's pension obligations are underfunded to the tune of $31 billion. Its unfunded liability for what are known as “other post-employment benefits” (OPEBs), which consist mostly of retiree health care, are estimated by industry analysts at almost $70 billion. That compares with GM's current stockmarket capitalisation of $15 billion.

What is bad for GM is bad for much of corporate America. Within the motor industry, Ford and Chrysler also face massive problems from “legacy costs” resulting from past promises to employees. Chrysler's prospects look least crippling, but then it was acquired by deep-pocketed Daimler a few years ago.



The motor industry is following a well-trodden path. Four of America's leading airlines are now flying whilst bankrupt; in each case, the opportunity to shed unaffordable pension and health-care costs has been a crucial factor in the decision to enter Chapter 11. America's steel industry went through a similar process a few years ago, emerging less burdened with legacy costs, but far smaller. Already, Wall Street analysts are starting to worry whether telecoms will be next, especially if the spread of low-cost internet telephony drives down the revenues of the remnants of the old Bell companies. Although their pension liabilities appear to be well funded for now, AT&T and SBC, which are currently merging, have combined unfunded OPEB liabilities of $20 billion.

Such high-profile financial difficulties are forcing many Americans to pay attention. Company bosses fear that they too may find themselves heading for bankruptcy or, if not, that legacy costs will at least make them uncompetitive. Workers fear that they will lose benefits that they are counting on in old age.

Politicians are fearful too, suspecting that taxpayers may end up having to pick up the bill. The Treasury secretary, John Snow, is worried that a meltdown of corporate pension funds could become the “next Savings & Loan crisis”, a reference to the scandals among thrift banks at the end of the 1980s that ended in a $200 billion government bail-out.

Already this year the Pension Benefit Guaranty Corporation (PBGC), the federal-government-backed insurer of company pension plans, has agreed to take on an unprecedented $6.6 billion in unfunded pension liabilities from bankrupt United Airlines, prompting allegations in Congress that airlines are trying to “dump” their pension obligations on taxpayers. The PBGC's liabilities now far exceed its assets, making it technically insolvent, though it has cash reserves that will keep it afloat for a few years yet.

Dealing with pension and health-care problems is distracting America's bosses from their core business—assuming managing legacy costs has not become just that: GM has been described, not

wholly in jest, as a pension hedge fund and health-insurance business that happens to make cars.

Suffering smokestacks

The burden of legacy costs is heavily concentrated in older manufacturing firms with (at least until recently) large workforces and unions strong enough to negotiate generous retirement benefits. Those firms are thus at a big cost disadvantage both to their younger domestic rivals—Southwest, America's most successful airline, has no pension fund to restrain it—and to competitors from countries that either lack pension and health-care provision or have it provided by the state.

In pensions, most of the problems lie in “defined-benefit” plans, under which the employer promises to pay a pre-agreed pension (usually a proportion of each employee's final salary). In the past 20 years, firms have been closing such funds, at least to new workers. They now favour “defined-contribution” schemes, whereby the firm promises to make regular payments into a pot that will pay a pension that reflects the market performance of the money invested. This gives the employer certainty about its costs, whereas the employee—unlike in a funded defined-benefit scheme—faces uncertainty about what pension he will have.

Despite this trend, some three-quarters of the companies in America's S&P 500 index have a defined-benefit pension fund. The total liabilities of these funds were around $1.4 trillion at the end of 2004 and, according to Credit Suisse First Boston (CSFB), these were underfunded by 13%, or some $165 billion. The more cautious PBGC reckons that the total obligations of America's single-company defined-benefit plans were underfunded by over $450 billion at the end of 2004. According to CSFB, in the S&P 500 these liabilities are concentrated in relatively few firms, airlines and carmakers prominent among them.

Equally worrying are multi-employer pension funds, says Trevor Harris of Morgan Stanley. They are administered by the unions—the Teamsters, for example, runs one for the trucking industry called Central State—but funded by employers. They are opaque even to the PBGC, but certainly are seriously underfunded. It is unclear which firms owe how much. If that were not bad enough, continues Mr Harris, corporate pensions are but a leading indicator of what lies ahead for state and local-government defined-benefit plans, which are even more severely underfunded.

Of course, corporate America is by no means alone in its pension crisis. Many British firms have similar problems, including British Airways and Corus, which includes what was once British Steel. Worries about pension liabilities have helped to scupper takeover bids for two prominent British retailers, Marks & Spencer and WH Smith, and caused wobbles in this year's acquisition of Allied Domecq by Pernod Ricard, another drinks firm.

America is unique however in the central role played by employers in financing health care. In most countries, health care is largely funded by the taxpayer and is thus much less of a direct burden on companies. Rick Wagoner, GM's boss, spoke for many American executives earlier this year when he said that the “cost of health care in the US is making American business extremely uncompetitive versus our global counterparts”. Strikingly, as if to prove his point, the car industry has been booming in Canada in recent years as Detroit's Big Three and their suppliers have shifted operations north of the border in search of savings.

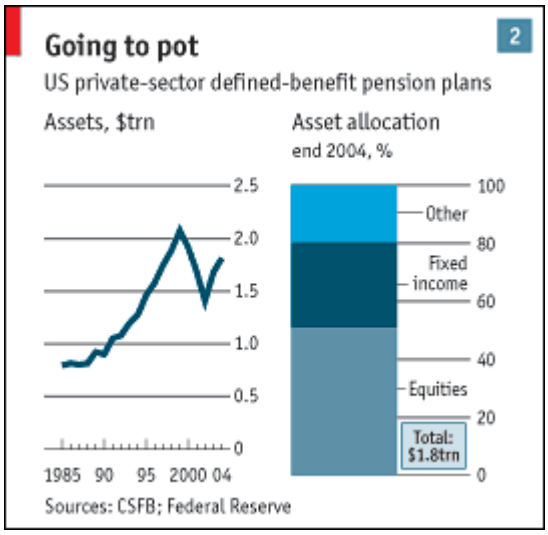
Hurt by health

True, the competitiveness problem can be overstated. After all, in theory, state funding of health care abroad should mean a higher tax burden compared with America, some of which is likely to

be felt, one way or another, by the corporate sector. But legacy health-care costs, in particular, probably do hurt American firms.

Unlike pensions, which have funding requirements under the 1974 Employee Retirement Income Security Act, there is no legal obligation to set money aside for future health-care promises. Health care for retirees is largely paid out of current cashflow, adding to a firm's costs relative to its foreign rivals but not to its output that year. Future OPEB obligations can affect the perceived creditworthiness of American firms and thus their cost of capital, by more than the impact of potentially higher future tax bills or labour costs on foreign rivals in countries with state-financed health care.

CSFB estimates that two-thirds of S&P 500 companies have some OPEB obligations, and that these are underfunded by well over $300 billion, more than 80% of the total promised benefits. (Some firms have put money into “voluntary employees' beneficiary associations”; for example, GM's contains several billion dollars.) Again, the burden is heavily concentrated in older, unionised firms. (Union-unfriendly Wal-Mart's health plan covers less than half of its American workers and does not extend into retirement.)



Worse, estimates of OPEB liabilities rely even more on guesswork than defined-benefit pensions, points out Olivia Mitchell of the Wharton School. Companies have simply promised to pay for whatever health care is required, regardless of the cost. At least a defined-benefit pension has a pre-agreed relation to final salary. In forecasting future health-care costs, actuaries “tend to assume 10-11% growth next year, trending down to, say, 5% in year five”, says Ms Mitchell, “but there is no actual evidence of health-care inflation ever trending down.”

So what went wrong? In pensions, three trends came together, says Dambisa Moyo, an economist at Goldman Sachs. First, companies were caught out by the decline in equity prices and lower interest rates after 2000 that reduced the value of pension-fund assets and, by lowering the discount rate, increased the present value of future liabilities. Second, firms failed to match the risk profile of their assets (which often consisted mainly of equities) with that of their liabilities, which are equivalent to a long-term bond. As a result, “lower interest rates have had a bigger impact on pension liabilities than on assets,” she says. Third, companies underestimated the life expectancy of their employees and thus the size of their liabilities. In America, until recently, many firms have used mortality tables from 1983, since when life expectancy has risen sharply.

Retiree health-care promises first started to grow in the 1970s as a way to circumvent President Nixon's wage controls. Managers subsequently came to see them as a relatively painless way of giving something to the unions during negotiations without having any impact on current costs. Considerable blame falls on how America has accounted for pensions and OPEBs. This has made it hard for anyone to understand the sort and magnitude of risks being taken, whilst at the same time creating incentives for managers to behave imprudently. For instance, firms are allowed to “smooth” out movements in asset prices, so that their profits are not excessively volatile. This is done by simply assuming in any given year that the assets earn a particular rate of return, and equities a higher return than bonds.

Fooled by arbitrage

These rules create a “fallacious arbitrage opportunity”, says Zvi Bodie, an economist at Boston University, by encouraging firms to issue bonds and buy equities for their pension fund. This is what GM did a few years ago when it borrowed $18.5 billion for its pension fund and promptly reported a big improvement in the fund's health by assuming that the equities it bought earned a higher return than the interest it was paying on the bonds.

Mr Bodie points out that the rules reflect the mistaken idea, “actually believed by actuaries, that equities are basically not risky if you hold them for the long term”. A good start to sorting out this mess would be to adopt accounting rules that make sense, for example by insisting on the use of true current market valuations. Britain has taken a big step in this direction with a rule called FRS 17, and the result has been a move of pension fund assets out of equities into bonds, which offer a better match to the relatively fixed obligations of defined-benefit pensions. However, hoping perhaps for a rise in share prices and/or interest rates, most firms have been reluctant to go as far as Boots, which in 2001 switched its fund entirely to bonds (a move that was subsequently watered down). That may prove to be a mistake, says Mr Bodie.

America's Financial Accounting Standards Board (FASB) has said it intends to improve pension-fund accounting, though it remains to be seen if it can do a better job of resisting hostile lobbying from companies than it did when it proposed tougher accounting for employee share options. The Securities and Exchange Commission is also taking an interest in this area.

Further, the Bush administration has proposed raising the premiums charged to firms by the PBGC, which is supposed to be self-financing. Ideally, premiums should reflect the riskiness of individual pension funds. However, this idea is facing considerable opposition, not least from unions, which argue that charging higher premiums to firms already unable fully to fund their pensions will push more of them over the edge into bankruptcy.

Tackling the OPEB burden may be even harder. A growing number of firms are trying to find ways to reduce health-care inflation by getting consumers to bear more of the cost, giving hospitals a financial incentive to be efficient and by promoting healthier lifestyles. So far, there is not much evidence of success. More company bosses are calling for a greater role for government in financing retiree health care, and are hopeful that the new Medicare prescription benefit, which should reduce their legacy costs a bit, is the start of a trend. Whether that view is shared in Washington, DC, remains to be seen.

Failing that, companies may simply have to be less generous. Sears, for instance, recently announced that it would no longer subsidise health insurance for retirees (though existing retirees have their subsidies grandfathered). There is much debate about whether OPEB promises are legally binding in the way that pensions are. In the past 15 years, many firms have couched their promises in legalese that appears to give them wiggle room.

Yet cutting OPEBs may be far harder than many firms believe, particularly where they are the result of a union negotiation, says Christine Lutgens, a lawyer at Kramer Levin. Although courts across America differ in their view of how binding union OPEB promises are, particularly in a bankruptcy, those serving Detroit (unlike in New York and Texas) have tended to favour the rights of union employees and retirees over employers, she says.

At those firms where legacy costs are creating a genuine risk of bankruptcy there is no shortage of opportunities for headline-grabbing short-term strategies, such as strikes by the unions or threatened bankruptcy filings by management. Chapter 11 is a useful card for bosses, because the PBGC does not guarantee the full amount of most pensions. On the other hand, firms have no automatic right to dump their pension funds on the PBGC even in bankruptcy, unless it is clearly necessary in order for them to survive.

Chapter 11 has actually made matters worse in many industries—most recently, for airlines—by giving a new lease of life to the worst performing firms that allows them to hurt their solvent and better-run rivals. A powerful case can be made for reforming Chapter 11 so that true basket-cases can be put out of their misery before they bankrupt entire industries. Unfortunately, Congress seems more intent on finding ways to help airlines postpone their day of reckoning. For instance, it has been proposed that Delta and Northwest, which filed for bankruptcy last month, be given a 14-year grace period in which to restore their pensions to full funding.

Tough talks ahead

Intriguingly, one reason why Delphi entered bankruptcy when it did was to avoid modestly tougher Chapter 11 rules that take effect on October 17th. Another reason suspected by many in Detroit was that GM urged Delphi to enter Chapter 11 in order to send a signal to the United Auto Workers union. The theory has it that GM would like to soften up the UAW ahead of contract negotiations that may determine its future viability.

The UAW is apparently receiving high-level advice on strategy from the Union of Steel Workers. Wilbur Ross, a financier who made an impasse-breaking deal with the USW that enabled the bankrupt steel industry to consolidate and leave Chapter 11 in good shape, notes two important lessons from that experience that the UAW—and others, too—might do well to heed. First, American firms need to be globally competitive and can no longer afford to award pay and fringe benefits solely according to American norms. Secondly, “at the end of the day, the only job worth having is one at a solvent company. What's the point of a gold-plated contract with a firm that is going bust?”

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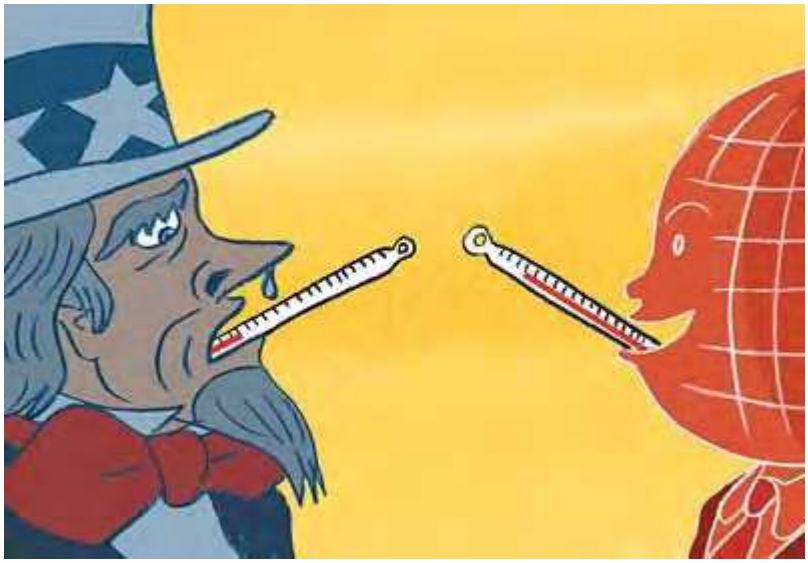
Economist.com FINANCE & ECONOMICS

Equity markets

America's ague

Oct 13th 2005
From The Economist print edition



Why America's stockmarkets are ailing while others are hale

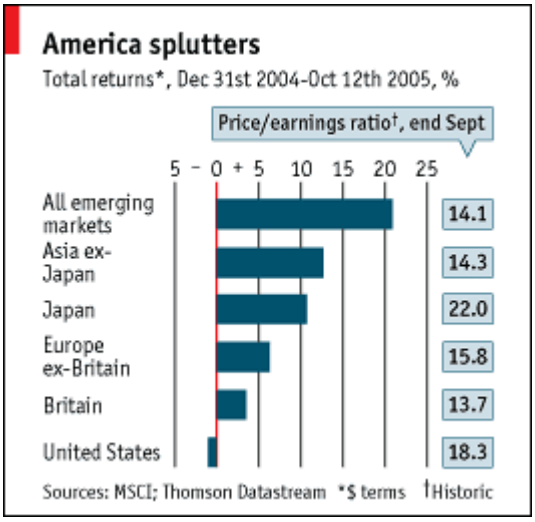
STOCKMARKETS around the world have had a ropey couple of weeks. First renewed fears about inflation, then the biggest bankruptcy yet of an American manufacturer (Delphi, a maker of car parts), pushed share prices down for a bit. But contrary to the old saying that when America sneezes, the rest of the world catches cold, the rest this time suffered less and recovered faster, thank you.

Shares have generally done less well in America this year than in Europe, Japan and emerging markets. Britain's FTSE 100 hit a four-year high this month. So did Japan's Nikkei, late in September. The Chicago Mercantile Exchange has just announced a new derivative contract on Asia's top shares, to capture their ebullience. American share prices, meanwhile, are moving sideways.

As the chart shows, the total return (including price appreciation and dividends) on equities in America has been slightly negative this year. In continental Europe, it has been a bit over 6%. Emerging markets, recent stars in the investing firmament, have returned even more, 21% to date. One of the brightest, Brazil, has produced 47%; others—in the Middle East, for example—even more. And this is after translation into dollars. In most instances, the difference in local currencies is even starker.

This is an odd state of affairs, on the face of it. America's economy has been the wonder of the western world, shaking off rising interest rates and sharply higher oil prices to persist in growth that is the envy of much of

Europe. Its debt-ridden, gas-guzzling consumers have only recently begun to show signs of flagging. And most firms are defending their profit margins.



Explanations range from the technical through the fundamental to the psychological. Relative valuations head the list. American equities were more expensive than those elsewhere when the year began, and the gap, though smaller now, remains. Stockmarket valuations are always a contentious business, but most measures show the same pattern.

Another negative factor is that interest rates are rising and the yield curve is flattening, both normally bad signs for business. While the Federal Reserve has hiked short rates by 275 basis points (hundredths of a percent), since June 2004, the difference in the yields on ten-year and two-year Treasury bonds has shrunk from 192 to 20 basis points. Against this, the euro zone's central bank has held rates steady for more than two years, and Britain recently cut them. And while long-term yields in America are lower than they were when the Fed started raising short-term rates, they are still higher than in almost any other rich country (Australia is an exception). Shares globally look cheap relative to bonds when yields on the two are compared, but in America they look less cheap than elsewhere.

Then there are “fundamentals”, and each country has its saga. Germany's companies have restructured and cut costs, helped by cheap labour in central Europe. With a large manufacturing sector by the standards of developed countries, its export-oriented firms are riding the wave of global industrial expansion. Japan, for its part, is coming out of seven years of deflation with its companies modernised and profits shooting upwards—and maybe more economic reform ahead. Emerging markets have been re-rated, thanks to broadly more investor-friendly economic policies and booming commodity prices.

In America, by contrast, several worries are sapping optimism about economic prospects. One concern is inflation: though the evidence is mixed, it may be making a comeback. Another is the country's trade and budget deficits, which by some lights appeared to be improving until Hurricane Katrina boosted the government's projected outlays. A third has to do with the sustainability of corporate earnings: America's are among the farthest above their historical trend and thus may have farthest to fall.

Americans themselves prefer foreign shares these days, another reason why their own are lagging. The trend, though volatile, has been rising since March 2004. This June the net outflow was $11.8 billion and in July $8.9 billion, on Treasury figures. “This supports the view that American investors are not that pleased with the valuations on US equities and think that other markets are more geared to the pick-up in the world business cycle,” says Richard Batty, global strategist at Standard Life Investments, part of a British insurer.

Anywhere but America

Mutual-fund flows confirm the Treasury trend and bring it up to date. Brad Durham, managing director of Emerging Portfolio Fund Research, which monitors mutual funds with $2.3 trillion in assets, says that net flows into American-domiciled American-equity funds are just positive for the year so far, but have deteriorated sharply. Net outflows in August were $6.9 billion, and a further $2.2 billion or so has walked since. Meanwhile, mutual funds based in America have poured $14.5

billion this year into emerging markets, another $14.5 billion into global and international funds and $5.5 billion into Japan. Europe suffered outflows earlier in the year, but is now attracting dollars.

Behavioural finance contributes a final piece to the puzzle. A new paper published by London's Centre for Economic Policy Research looks, unusually, at trust—confidence that financial data is reliable, that the overall system is fair—as a factor in stockmarket participation. The authors (Luigi Guiso and Luigi Zingales, of the University of Chicago, and Paola Sapienza, of Northwestern University) find that levels of trust, variously defined, are correlated with investors' propensity to buy shares. This supports the notion that scandals involving the likes of Enron and WorldCom may have turned off American investors. Indeed, Italy, whose once-tainted Parmalat returned to the stockmarket last week, is another underperformer.

Are America's shares now poised to close the gap? A couple of short-term indicators are less than bullish. For one thing, analysts have steadily raised the bar in their earnings forecasts, making it increasingly likely that companies will stop beating and start missing their targets. Investors often punish that. And for another, the number of companies suspending their dividends rose last month: to 11, from a monthly average of under three, points out Mark Hulbert, a market commentator. Though only a few firms are involved, the trend may be significant: much academic literature suggests that when a company suspends its dividend, returns on its shares fall over the next 12 months.

The broader outlook is more encouraging, however. Most forecasters believe that America's growth will continue to outpace Europe's. Equity valuations are more in line than they were. And the bloom is slightly off various developing-country roses. The dependence of Asian countries on imported oil, a possible peak in commodity prices and some emerging political risk in Latin America are all things that investors are keeping an eye on. Nor does Japan fill everyone with confidence, for it is foreigners, not locals, who are pouring the money into shares there.

An intriguing twist in Credit Suisse First Boston's much-followed risk-appetite indicator seems to confirm this view. Last week, it shot into the “euphoria” zone for several days, which would normally be a signal to sell equities. But for the first time in ten years, enthusiasm for developed countries' shares did not accompany the spike, points out Andrew Garthwaite, a global equity strategist. It is bonds that investors are crazy about, plus shares in Japan and some emerging markets. Continental and American equities leave them cold, and British ones even colder. The indicator last shot up without support from shares in 1995, the beginning of a memorably snorting bull market in equities. Without implying anything half so dramatic now, the moral would appear to be to buy shares, and buy—curiously—British.

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Measuring inflation

Pricing the future

Oct 13th 2005
From The Economist print edition

The cost of living has been increasing faster than you thought

FIGURES due on October 14th are expected to show that America's 12-month rate of consumer-price inflation rose above 4% in September, to its highest since 1991. Yet in recent years, this gauge may have understated the true pace of increase in Americans' cost of living. The problem with conventional inflation measures, such as the consumer-price index (CPI), is that they measure only the prices of goods and services consumed today. But because people live for many years they also care about the prices of what they will consume tomorrow.

In a new paper, Ricardo Reis, an economist at Princeton University, has attempted to calculate a "dynamic price index" (DPI) for the United States, which takes account of future as well as current prices. Unlike the CPI, it includes the prices of shares, bonds and houses. Assets are claims on future goods and services, and so asset prices reflect the price of consumption in the future relative to the present. If share or house prices rise sharply, future consumption becomes more costly, and so the cost of living increases.

To illustrate his calculations, Mr Reis takes somebody approaching retirement who has a given amount of money to live on until he dies. He then calculates by how much the retirement fund must be adjusted each year to allow the person to afford the same standard of living given changing prices.

Over the past three decades as a whole, Mr Reis's DPI has followed a similar downward trend to the CPI. But in recent years the gap between the two has widened. In the four years to 2004, the average annual rate of inflation according to the DPI was 7.4%, compared with an average increase of only 2.3% in the CPI. This was largely due to the rising price of homes. The true rate of increase in workers' cost of living is calculated to be just as high. Still feeling as well off as you did?

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Economist.com FINANCE & ECONOMICS

The Doha trade round

A stopped clock ticks again

Oct 13th 2005
From The Economist print edition

But time is running out

Get article background

THIS week, Zurich played host to ministers from five of the most important players in world trade negotiations: America, Australia, Brazil, the European Union and India. Next week, these same guests will grace Geneva. The ministers do not need one of Switzerland's expensively engineered timepieces to know that it is very late in the day for the Doha round of trade talks. A crucial summit, in Hong Kong in December, is fast approaching.

Fear of a flop brings out one of two responses in politicians. Either they push harder for success; or they start running from the blame for failure. Both motivations probably played a part in America's encouraging proposal this week to shake up agricultural trade.

America can currently spend up to $19.1 billion on farm-production subsidies, which heavily distort trade. The EU can spend over $75 billion. Robert Portman, America's trade representative, offered to cut his country's limit by 60%, if the EU agreed to cut its permitted subsidies by 80%. Mr Portman also suggested limiting other subsidies, which do not distort trade as heavily, to 2.5% of the value of agricultural production. These two limits provide plenty of scope for creative accounting. Even as America lowers the ceiling on the most trade-distorting subsidies, some of this money will be reclassified as something else.

To the big agricultural exporters, such as Brazil, handouts to rich-world farmers, however galling, matter less than access to rich-world consumers. The trade powers appear to have settled on how to cut farm tariffs, if not by how much. Following a scheme outlined in July, tariffs will be divided into four “tiers”, according to their height. Those in the top tiers will be cut by more than those in the bottom. This week, Mr Portman proposed that rich countries should cut any tariff over 60% by as much as 90%, and any under 20% by more than half. No rich country should impose a tariff above 75%, he said.

These are big numbers. But they refer to internationally agreed ceilings, above which countries cannot raise their tariffs. Since most tariffs are currently set well below these limits, lower ceilings may not result in many actual reductions.

Nonetheless, the EU was unable to match the offer. The cuts its trade commissioner, Peter Mandelson, proposed in response were less deep, and their scope less wide. Only tariff ceilings above 90% would be lowered by more than half; and the maximum tariff would be set at 100%. The EU also wants to spare 8% of its products from tariff-cutting. According to research at the World Bank, if even 2% escape the chop, 75% of the benefits of a successful round would be wiped out.

Mr Mandelson did push things forward on industrial tariffs and insists that services should not be the “Cinderella” at the Hong Kong ball. His position is not easy. France's trade minister thinks he

has already gone too far. Meanwhile, America's farm lobby and its placemen in Congress complain that a trade deal would tie their hands when they write the next farm bill, before the current act expires in 2007. Hong Kong is imminent, and success still distant. But for the first time in a while the protectionists sound a bit nervous. That should give everyone else a bit of hope.

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Economist.com FINANCE & ECONOMICS

Financial scandal

A broker battered

Oct 13th 2005 | NEW YORK
From The Economist print edition

A big futures broker is rocked by an alleged fraud

THE chief executive of Refco, one of America's largest futures brokers (and its biggest retail commodities broker), was arrested on October 11th. Federal prosecutors have charged Phillip Bennett with defrauding investors in the firm's initial public offering, which took place only in August, by hiding hundreds of millions of dollars in loans to another company that he controls. If he is convicted of the charge, Mr Bennett faces 20 years in prison, as well as hefty fines.

Federal prosecutors became aware of the possible scheme on October 10th, when Refco announced the findings of an internal review. This showed that Mr Bennett had borrowed $430m through a third company. The money was repaid on the day of the announcement, and Mr Bennett was placed on leave. The news triggered pandemonium in the financial markets: Refco's share price fell by more than half in two days (and lost even more the day after the arrest). An investigation began immediately and prosecutors worked round the clock to prepare a case. They say that since late last year Mr Bennett had “actively participated” in a scheme to hide as much as $545m, with the money cleverly repaid just before routine audits.

The initial internal review found a receivable owed to Refco by a firm controlled by Mr Bennett. This largely consisted, the firm believes, of “uncollectible historical obligations owed by unrelated third parties” to Refco. These obligations were transferred periodically to Mr Bennett's firm; Refco's accounts then reflected a receivable from that entity. The fact that the receivable was from a firm controlled by Mr Bennett was “hidden at the end of... reporting periods”, says Refco, in transfers to a (probably unconnected) customer account. Refco has said that financial statements as far back as 2002 cannot be relied on and that questionable transactions may date back as far as 1998.

Banks, hedge funds and the myriad institutions that used Refco as a counterparty in trades are among those potentially affected by the fallout. There have been reports of customers moving their positions and capital out of the firm. On October 11th Refco was hit by a class-action lawsuit on behalf of shareholders who purchased the company's stock between August 11th, the date of the flotation, and October 7th.

Some observers also wondered how some of America's smartest financial firms had missed the sums that Mr Bennett is alleged to have taken out of the firm. These include Thomas H. Lee Partners, a big private-equity firm which holds a major stake in Refco, as well as the investment banks that underwrote the company's IPO: Credit Suisse First Boston, Goldman Sachs and Bank of America took the lead.

More broadly the scandal was an unwelcome blow to the futures industry, which has tried for years to shed its reputation as a hotbed of slick operators. The phenomenal growth in the trading volume of futures—essentially risk-management instruments in commodities and financial instruments—has far outpaced that in equities in recent years, and brokerage firms have ridden the wave.

Ironically, Refco's public image has not conformed to this racy stereotype. Mr Bennett, say some in the industry, kept a low profile. The public face of the firm in America has been Joseph Murphy, the company's president and the chief executive officer of Refco Global Futures, a subsidiary. Mr Murphy currently serves as chairman of the Futures Industry Association, the leading trade organisation and a driving force in efforts to burnish the image of the futures business. He has not been implicated in the scandal.

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Economist.com FINANCE & ECONOMICS

Italian finance

Still in the driving seat

Oct 13th 2005
From The Economist print edition

How the Agnelli family retained control of Fiat

WHAT a difference a year makes. Twelve months ago Fiat, Italy's largest industrial group, was going from bad to worse. Now, helped largely by a €1.5 billion ($2 billion) divorce settlement in February from General Motors, analysts expect Fiat to record a pre-tax profit of over €1 billion this year. This turnaround follows total pre-tax losses of over €8 billion since 2001. It has made the group more valuable to the Agnelli family, which through a cascade of companies controls IFIL Investments, a quoted company that is in turn Fiat's controlling shareholder.

However, when Fiat announced on April 26th that it would not repay in cash a €3 billion convertible loan from a consortium of banks, it looked as though IFIL might lose control. The banks could convert their loan into Fiat shares on September 20th, giving them 24% of the company and diluting IFIL from 30% to 23%.

Even so, IFIL said in June that it intended to keep control. This created a dilemma. When the banks converted their loans into shares, IFIL might have to buy more shares, probably at a premium, to avoid losing control of Fiat. But if IFIL raised its holding above 30% by buying more shares before September 20th, it would, under Italy's takeover rules, have to bid for the entire firm in cash, a costly undertaking even for the Agnellis.

So when IFIL said on September 15th that it had found a way of avoiding both dilution and a mandatory offer, it seemed to have pulled off an ingenious coup. As the banks converted their loans, IFIL simultaneously acquired sufficient shares to retain control—around 7% of Fiat's voting capital—at €6.50 a share, compared with the market price of €7.30.

The seller was IFIL's sister firm, Exor Group, a private company of which the Agnelli family directly owns 70%. Exor in turn bought the shares on the same day from Merrill Lynch, an American investment bank, at €5.60 a share under an equity swap, a type of derivative. Exor and Merrill had signed the swap on April 26th, the very day Fiat announced the conversion of the banks' loan. In April, Fiat's share price dipped to around €4.50, the lowest for years.

It looked rather opportunistic that the deal made Exor a profit of €74m at IFIL's expense. At the insistence of Consob, Italy's stockmarket regulator, and in response to critical press articles, IFIL has published more details of the transaction. With the benefit of this information, a cynic might suspect that what happened in September had been pre-arranged in April and so should have been disclosed to the market then. So, in solving its dilemma, had the Agnelli family in effect abused the market to the detriment of Fiat's minority shareholders while it, through Exor, made money on the side? Or did it simply find the cheapest way of stabilising the ownership of Fiat, to the benefit of IFIL's shareholders great and small?

Under the swap, Merrill was to buy 90m Fiat ordinary shares by June 7th. It bought them for €495m, an average of €5.50 per share. Merrill was to sell the underlying shares on the swap's expiry in December 2006, or sooner if Exor requested early settlement. If the proceeds exceeded

€495m, Merrill would send Exor the surplus in cash, less its funding costs. If they were below €495m, Exor would send Merrill the cash to cover the deficit and the investment bank's funding costs. The swap thus insulated Merrill from any risk relating to Fiat's share price.

The swap could have specified an alternative method of settlement, known as physical delivery. Under this method, Merrill would sell the shares to Exor for €495m plus its funding costs. Equity swaps of this size specifying this form of settlement have to be disclosed to Consob. But those to be settled in cash (derived from the sale of the shares in the swap) do not. So in this case no disclosure to the market was necessary.

From Merrill's point of view, there was no financial difference between settling in cash and physical delivery. But for Exor there was a big difference: it wanted the shares themselves, not cash for the increase in their value over €495m. So on September 15th, the two firms agreed to revise their swap contract to enable Merrill to sell the shares themselves to Exor. But this required disclosure under the law.

Merrill subsequently declared, as it was legally required to do, that its stake in Fiat had crossed the 5% and 10% thresholds on September 15th. However, according to the swap contract, the investment bank was supposed to have bought 90m shares, more than the 5% trigger of Fiat shares, by June 7th. This was more than three months before it disclosed the holding to Consob.

If Merrill held the shares directly, or through derivatives that specified delivery of shares, it should have declared the holding. So it must have executed cash-settlement equity swaps with third parties who agreed to a switch from cash settlement to physical delivery at the same time as Merrill itself did with Exor. Merrill Lynch has not answered our written questions.

Because of spikes during July and August in Fiat's share price and the volume of shares traded, Consob twice asked IFIL if it knew of any reason for the shares' volatility. On both occasions (July 26th and August 24th), IFIL told the market, at Consob's behest, that it did not. Gianluigi Gabetti, the chairman of both IFIL and Exor, has justified IFIL's response on the grounds that Merrill's buying ended on June 7th, some weeks before Consob's first request.

According to Mr Gabetti, the change to the terms of the settlement of the swap was “obviously not anticipated”. On August 24th IFIL told the market, again at Consob's behest, that it had neither “undertaken nor studied any initiative in relation to the expiry of the convertible loan”. IFIL has said that it found the solution implemented on September 20th only after August 25th.

This explanation means the existence of the swap was a felicitous coincidence; so too its mechanics, which left Merrill indifferent to switching from cash settlement to physical delivery. According to Mr Gabetti, the swap was essentially an informed bet that Fiat's share price would go up. Yet the existence of the swap certainly helped IFIL—and the Agnellis—to stay in control. Had Exor terminated the swap, Merrill would have sold the underlying shares on the market, thereby increasing the chances of control of Fiat falling into someone else's hands. While the swap remained open, Exor in effect controlled the underlying shares because Merrill Lynch would not sell them.

It is conceivable that the swap was no more than an informed bet. However, it is more plausible to see it as essential planning for the conversion of the loan in September, and the swap's original cash-settlement terms as an ingenious plan to avoid informing the market. If this is what happened, the losers from the manoeuvre would have been anyone who sold Fiat shares when the shares underlying the swap were being bought. And only those who take IFIL's explanation at face value could then still feel comfortable investing in a quoted company that the Agnelli family controls.

Economist.com FINANCE & ECONOMICS

Macquarie Bank

London calling

Oct 13th 2005 | SYDNEY
From The Economist print edition

The heady climb of an unusual investment bank

THIS week, for the first time in its 20-year history, Macquarie Bank held a board meeting in London, the first outside Australia, its home country. Allan Moss, Macquarie's chief executive, says that nothing should be read into the timing: the meeting had been planned for more than a year, and the bank owns lots of assets in Britain. Others are not so sure. In August, the bank said that it might bid for the London Stock Exchange, already the subject of attention from other European bourses. Rumours about the preparation of such a bid have been flying about since.

The idea fits Macquarie's unusual style. As well as offering conventional investment banking, fund-management and retail financial advice, the bank has been an eager acquirer, via funds and trusts, of firms and infrastructure. In Britain alone it made a string of purchases in the past 18 months, from a ferry operator to a gas distributor, to add to the M6 toll road and the two airports it already owned.

Macquarie has grown from two offices, in Sydney and Melbourne, into the manager of a portfolio worth A$89 billion ($67 billion) and the employer of 7,000 people in 23 countries. In the year to the end of March, it made a profit of A$823m, an increase of 67%, and the value of its portfolio went up by more than 40%. Its income outside Australia rose by 83%, and now accounts for almost 40% of the total.

The action rolls on. On October 4th Macquarie launched a new fund, to invest in media assets. It will be financed by an initial public offering that is planned to raise A$927m-996m. The stockmarket likes what it sees: the share price is almost 60% higher than in mid-April. This helps to explain why Mr Moss is Australia's longest-serving chief executive. Having clocked up 12 years in a land where the average boss lasts for about four, he reckons: “I'm probably approaching 250 years old.”

A rum choice of name

Macquarie was formed in 1985 from the Australian arm of Hill Samuel, a British merchant bank. It was listed on the Australian stock exchange 11 years later. The original team included both Mr Moss and David Clarke, now the executive chairman. They trawled history books to name their bank after a great Australian. “Remarkably,” says Mr Moss, “quite a number are not necessarily the sorts of people whom you would choose for the name of a bank, actually.” They settled on Lachlan Macquarie, an early 19th-century governor who brought order to the chaos of colonial Sydney, in which rum was often used as currency. The governor bought Spanish silver dollars, punched out the middles and thereby created two new coins: the punched-out bit and one with a hole, which became the bank's symbol. “It was the first Australian financial innovation,” says Mr Moss. “it was of great benefit to the community and it made money. It's a symbol we feel proud of.”

The bank is making money too—not least for its bosses. In 2004-05, Macquarie's top seven executives were paid a total of A$89m; Mr Moss's share was A$18.5m, mainly from “performance-related” fees added to his salary, making him Australia's highest-paid chief executive. The fees, he says, are “market rates for the work we do”. Macquarie, he notes, has raised A$17 billion in venture capital in the past 18 months, half at home and half abroad. Clearly, he says, clients have confidence in Macquarie's business model. A key strategic theme is “not being constrained by conventional views of what investment banks should do”.

This unconventional model took shape about ten years ago, when Macquarie won a tender to build the M2 toll road in Sydney by floating a company that would own the road; original investors have reaped a ten-fold return. Thereafter, Macquarie set up a series of listed funds covering toll roads, airports and communications: the media fund is the latest addition. Like its parcel of international property trusts, all have done well. The assets they own or manage range from a toll road in Chicago to a power company in Canada. The bank's image took a battering three years ago, after it paid almost A$6 billion for Sydney airport, when Virgin Blue, a low-cost carrier, accused it of reneging on an access deal. Virgin launched billboard advertisements with the bold slogan “Macquarie: what a bunch of bankers”, before the dispute was settled.

The common theme behind this disparate group of assets, says Mr Moss, is finding businesses that “have some protection from the full rigours of competition.” This means buying shopping centres, industrial properties, airports, toll roads and broadcast towers in locations that pretty much have the field to themselves: as more people want to use them, their revenue streams will keep on growing.

So far, this approach has worked exceptionally well. Could it come unstuck—because of a global downturn, say, or, as some critics suggest, simple hubris? Mr Moss counters that risk management is his most important job. Macquarie, he says, continually estimates what would happen if markets fell by as much as 40% in a day, and makes sure it is confident the bank would still be in good shape at the end of such a catastrophe. Such methods will continue to be needed if it is to steer clear of the grand visions that have sunk more flamboyant high-flyers.

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Economist.com FINANCE & ECONOMICS

Economics focus

War games

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From The Economist print edition

A big pay-off for two game theorists

THIS year's Nobel prize for economics might almost have doubled as the prize for peace. On October 10th, three days after the International Atomic Energy Agency and its director-general, Mohamed ElBaradei, won their laurels for monitoring the misuse of nuclear power, the economics prize was bestowed on two scholars whose best work was also done in the shadow of the mushroom cloud.

Robert Aumann, of Hebrew University, and Thomas Schelling, of the University of Maryland, are both game theorists. Game theory is now part of every economist's toolkit and has been recognised by the Nobel award before, when John Harsanyi, John Nash and Reinhard Selten shared the honour in 1994. It is the study of what happens when the calculating, self-interested protagonist of economic fable meets another member of his kind. In such encounters, neither party can decide what to do without taking into account the actions of the other.

During the cold war, two protagonists that captured game theorists' imaginations were the United States and the Soviet Union. How each of these nuclear adversaries might successfully deter the other was the most pressing question hanging over Mr Schelling's classic work, “The Strategy of Conflict”, published in 1960. The book ranged freely and widely in search of an answer, finding inspiration in gun duels in the Old West, a child's game of brinkmanship with its parents, or the safety precautions of ancient despots, who made a habit of drinking from the same cup as any rival who might want to poison them.

Mr Schelling's back-of-the-envelope logic reached many striking conclusions that appeared obvious only after he had made them clear. He argued that a country's best safeguard against nuclear war was to protect its weapons, not its people. A country that thinks it can withstand a nuclear war is more likely to start one. Better to show your enemy you can hit back after a strike, than to show him you can survive one. Mr Schelling invested his hopes for peace not in arms reductions or fall-out shelters but in preserving the ability to retaliate, for example by putting missiles into submarines.

All-out thermonuclear warfare is the kind of game you get to play only once. Other games, however, are replayed again and again. It is these that fascinate Mr Aumann. In a repeated encounter, one player can always punish the other for something he did in the past. The prospect of vengeful retaliation, Mr Aumann showed, opens up many opportunities for amicable co-operation. One player will collaborate with another only because he knows that if he is cheated today, he can punish the cheat tomorrow.

Mutually assured co-operation

According to this view, co-operation need not rely on goodwill, good faith, or an outside referee. It

can emerge out of nothing more than the cold calculation of self-interest. This is in many ways a hopeful result: opportunists can hold each other in check. Mr Aumann named this insight the “folk theorem” (like many folk songs, the theorem has no original author, though many have embellished it). In 1959, he generalised it to games between many players, some of whom might gang up on the rest.

Mr Aumann is loyal to a method—game theory—not to the subject matter of economics per se. His primary affiliation is to his university's delightfully named Centre for Rationality, not its economics department. Trained as a mathematician, he started out as a purist—pursuing maths for maths' sake—but soon found his work pressed into practical use. Between 1965 and 1968, for example, he co-wrote a series of reports for the United States Arms Control and Disarmament Agency. The Russians and Americans were pursuing gradual, step-by-step disarmament. But the military capabilities of each superpower were so shrouded in mystery that neither side knew precisely what game they were playing: they did not know what their opponents were prepared to sacrifice, nor what they themselves stood to gain. Without knowing how many missiles the Russians had, for example, the Americans could not know whether an agreement to scrap 100 of them was meaningful or not.

In such games, Mr Aumann pointed out, how a player acts can reveal what he knows. If Russia were quick to agree to cut 100 missiles, it might suggest its missile stocks were larger than the Americans had guessed. Or perhaps the Russians just wanted the Americans to think that. Examples of such deception are not limited to the cold war. Some have speculated that Saddam Hussein pursued a similar strategy in the run-up to the invasion of Iraq in 2003. Despite apparently having no actual weapons of mass destruction left, he offered only the most grudging co-operation to weapons inspectors. The Iraqi dictator perhaps wanted to conceal the humiliating fact that he had nothing much to hide.

Messrs Aumann and Schelling have never worked together, perhaps because the division of labour between them is so clear. Mr Aumann is happiest proving theorems; Mr Schelling delights in applying them. Mr Aumann operates at the highest levels of abstraction, where the air is thin but the views are panoramic. Mr Schelling tills the lower-lying valleys, discovering the most fertile fields of application and plucking the juiciest examples.

In one of his more unusual papers, Mr Aumann uses game theory to shed light on an obscure passage in the Talmud, which explains how to divide an asset, such as a fine garment, between competing claimants. You should give three-quarters to the person who claims all of it, and the remaining quarter to the person who claims half of it, the text instructs, somewhat inscrutably. Fortunately, the Nobel committee had no need for such a complicated rule in dividing up its prize. Between its two equally deserving laureates, it split the SKr10m ($1.3m) fifty-fifty.

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Economist.com SCIENCE & TECHNOLOGY

Earthquake science

Preparing for the unknowable

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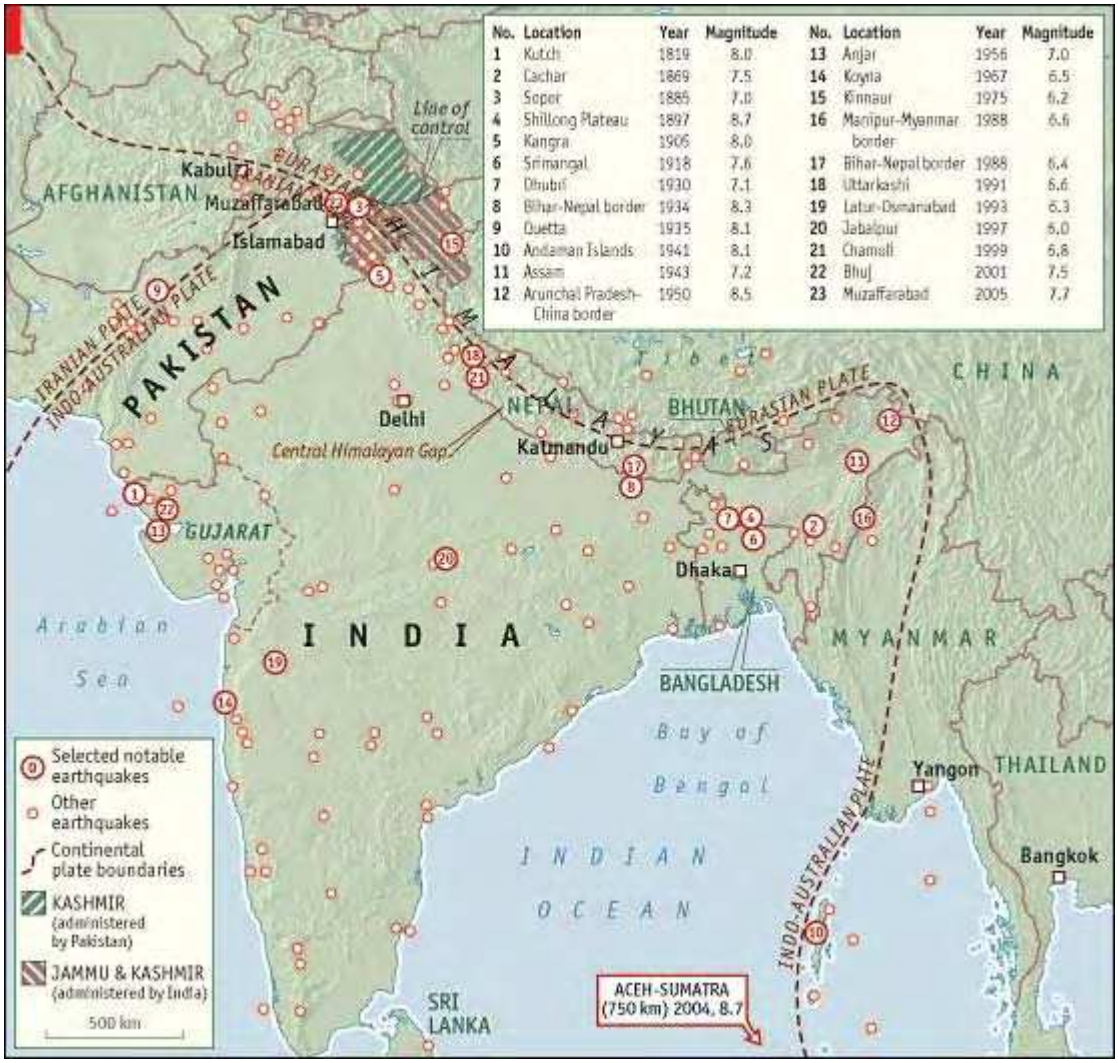

Why the Kashmir earthquake happened and what might be done

Get article background

PAKISTAN'S earthquake measured 7.6 on a scale known as the moment magnitude. This measure, a successor to Richter, allows seismologists to compare the energy released by different earthquakes. At each step of the scale, about 32 times more energy is released than at the previous step. It has no upper limit, but the largest recorded earthquake was in southern Chile in 1960 and measured 9.5.

Earthquakes happen mostly where the earth's tectonic plates collide. In Pakistan, quake activity is mainly concentrated in the northern and western sections of the country, along the boundary of the Indian, Iranian and Eurasian plates. The Indian plate is moving north at about 5cm a year, resulting in a force on the southern edge of the Tibetan plateau—the force that generates the Himalayas. As a result, earthquakes occur along the Himalayas all the way to Myanmar. (The movement of the Indian plate also caused the devastating Sumatra-Andaman earthquake and tsunami late last year.)

In recent years, Pakistan has not suffered as greatly from earthquakes as its neighbours in the Himalayas, Afghanistan, Nepal, China and India. Its biggest earthquake in living memory occurred in Quetta in 1935, with 30,000 deaths. Nevertheless, Kashmir is seismically active on both sides of the border, with many regular, though less damaging, quakes. In 2002 in the Gilgit-Astore region, 100km (63 miles) north of Muzaffarabad, large earthquakes made about 16,000 people homeless.

Across the Himalayas there is what seismologists call a “slip deficit”—a lack of earthquakes to release the stress that is known to be accumulating. The Kashmir quake was in just such a region, where a great earthquake was overdue. Nevertheless, Roger Bilham, of the University of Colorado, says it is doubtful that the Kashmir quake released more than one tenth of the cumulative energy stored there. Furthermore, in the past half-century the Himalayan region has seen fewer powerful earthquakes than might be predicted from historical records. The most notable area of concern is the central Himalayan Gap, a 600km-long central arc of the Himalayas. Mr Bilham believes this area has the potential to generate several earthquakes of magnitude 8 or more, and is the most vulnerable (in terms of potential loss of life and damage) of the regions that could produce a great earthquake. The whole of Nepal is also a worry.

The Kashmir quake may be the worst recorded in the Indian subcontinent. Its deadliness was linked, among other things, to the weakness of buildings, the depth of the quake, the density of population, the fault and soil types, and the intensity of the shaking. The Bhuj earthquake, only 100km from the border of Pakistan, was of similar magnitude but killed 18,500.

Because of population growth and density in the Himalayas, hundreds of thousands may be at risk—particularly in India, where the government and the United Nations Development Programme have identified 38 cities with more than half a million people located in the most seismically active regions. A way has to be found to reduce the deadliness of quakes in the most vulnerable areas.

Yet earthquakes cannot be predicted accurately enough to know when people should be evacuated. It is all the harder in the Himalayan region, with hidden underground faults that are poorly monitored by seismic instruments. That leaves two options, other than fatalism: to put up better buildings, and to improve planning for responding to disasters.

Progress is slow. Key buildings in need of better earthquake-proofing have been identified in Delhi, and work is under way. Similar plans elsewhere have come too late to help the hospitals in Indian Kashmir. Though it is impossible to make buildings completely resistant to earthquakes, they can be made much safer. In both India and Pakistan, building codes exist; in both countries, they have been poorly enforced, with masses of unprotected housing stock in areas of great danger.

In India, to build more suitable housing would add only 2-4% to construction costs. But in the poorest regions, such as Kashmir, most houses are built of local materials by the people who then live in them. In fact, in India, 80% of housing is owner-built. Architects and engineers, who might improve building and design, are in short supply. It is lack of knowledge and skills that is the main problem, rather than the cost of the work.

Greater scientific knowledge about the region's earthquakes and faults would much improve understanding of which areas are most at risk. For this reason, Mr Bilham wants to gather

evidence as quickly as he can before rain or earth-slips obliterate it. Astonishingly, he has been refused a visa.

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Economist.com SCIENCE & TECHNOLOGY

Vaccination

A drop of pure gold

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Reuters

A group of researchers attempts to estimate the economic benefits of vaccination

WHAT good is vaccination? Obviously it is good for the person receiving the vaccine, if he is thus prevented from suffering from a nasty disease. More subtly, it can be good for an entire population since, if enough of its members are vaccinated, even those who are not will receive a measure of protection. That is because, with only a few susceptible individuals, the transmission of the infection cannot be maintained and the disease spread. But in the case of many vaccines, there are non-medical benefits, too, in the form of costs avoided and the generation of income that would otherwise have been lost. These goods are economic.

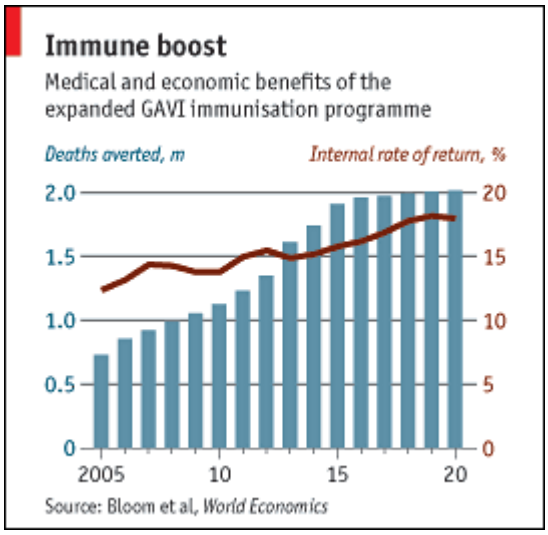
Quantifying these more general benefits is hard. But a pair of researchers from Harvard University has just tried. David Bloom and David Canning, together with Mark Weston, an independent policy consultant, have looked at two vaccination programmes and attempted to calculate the wider benefits. Their conclusions have just been published in *World Economics*.

Dr Bloom and Dr Canning believed that previous attempts to quantify the non-medical benefits of vaccination had been too narrow. These had looked at such data as the cost of a programme per life saved, but had failed to take account of recent work on the effects of health on incomes. For their study, they and Mr Weston identified how vaccination, in particular, might increase wealth.

The first benefit was that healthy children are more likely to attend school and better able to learn. The second was that healthy workers are more productive. Both of these seem fairly obvious. Two other benefits are less so, however.

One is that good health promotes savings and investment. This is because healthy people both expect to live longer (which gives them an incentive to save) and actually do live longer (which gives them more time to save). The other is that good health—and, particularly, expectations about the good health of one's offspring—promotes the so-called demographic transition from large to small families that usually accompanies economic development. None of these factors, the researchers thought, had been properly taken account of in previous estimates of the cost-effectiveness of vaccination.

To demonstrate that at least one of their ideas was correct, they turned to the Philippines. Here, a study called the Cebu Longitudinal Health and Nutrition Survey has been going on since 1983. It follows the lives of Filipina mothers and those of their children born in 1983 and 1984. Among the data collected were records of the vaccinations these children received as infants and also their scores in language, maths and IQ tests at the age of ten.



The three researchers organised children whose social circumstances were similar into groups, depending on whether or not the children had been vaccinated against a range of diseases including measles, polio and tuberculosis. They then compared test scores between groups. They found a statistically significant difference in the language and IQ scores between otherwise comparable vaccinated and unvaccinated children. In both cases, those of the unvaccinated were lower. Since it is known from other studies that these scores are good predictors of adult income, the researchers concluded that childhood vaccination would have significant economic benefits.

In order to predict those benefits, they turned to a vaccination campaign that is just beginning. The Global Alliance for Vaccines and Immunisation (GAVI) is a collaboration of governments, international organisations, vaccine-makers and charities. It is embarking on a 15-year programme to vaccinate children in 75 of the world's poorest countries against a range of childhood diseases. The programme is scheduled to cost $13 billion.

First, the researchers used data from previous vaccination programmes to estimate both the reduction in mortality and the improvement in the health of the living that might be expected to flow from the new GAVI programme. Then they combined these estimates with existing data about the economic effects of health improvement in these programmes in poor countries, in particular their effects on future income. Using standard accounting methods (calculating the interest rate that would make the net present value of the flow of future benefits equal to the initial costs) they calculate that the new GAVI programme can be expected to generate an immediate rate of return of 12.4%, rising to 18% by the end of the programme. And that does not include any benefits that might come from the demographic transition. The dispassionate economic case for vaccination, therefore, looks at least as strong as the compassionate medical one. If the figures produced by Dr Bloom, Dr Canning and Mr Weston are right, it truly is an investment for the future.

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Economist.com SCIENCE & TECHNOLOGY

Predicting influenza

Trading in flu-tures

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Betting on influenza outbreaks

EXTRAPOLATING from the adage “two heads are better than one”, a group of economists at the University of Iowa has learned how to turn the instincts of individuals into useful predictions of the future. So far, the researchers have tested their method by predicting the outcome of such events as the American presidential election and the number of books sold on the first day of a Harry Potter release. Now, they have turned their sights to influenza.

The influenza in question is not the pandemic bird-flu-related sort that is currently a cause for concern but the quotidian bug that lays people low, particularly in winter. Even this disease is not trivial. It kills, for instance, about 36,000 people in America and possibly as many as 12,000 people in Britain every year. If outbreaks could be predicted, patients at particular risk could be vaccinated and medical personnel redeployed in anticipation. So Philip Polgreen and his colleagues wondered if they could succeed where medical science had failed, and give adequate warning of influenza outbreaks.

America's Centres for Disease Control (CDC) track influenza cases in the country as they happen. A week later, they release the data, in part by using a colour-coded map. The colours reflect the level of influenza activity in each state on a five-point scale, with yellow representing “no activity” and red representing “widespread activity”.

In their study, Dr Polgreen and his colleagues gave 60 doctors and nurses based in Iowa 100 “flu dollars” each. The participants used these to buy and sell shares coded according to the CDC's colours for a particular week in the future, based on how many cases they thought would occur in the state during that week. For example, if a physician saw three young children with flu symptoms in his office, he might sell any yellow shares he had for the following week and buy red ones. Conversely, if no one he saw seemed to have trouble with influenza, he might buy more yellow or green (sporadic activity) shares for each of the next few weeks.

Over the course of the flu season from October 2004 to April 2005, 52 participants logged into the market as traders. They were able to buy and sell up to seven weeks in advance. At the end of the experiment, each flu dollar was converted into a real one and given to the participants in the form of an educational grant.

During the course of the season, the participants traded 8,072 shares with a total value of $2,392. And it worked. The flu market was able to predict the colour of a given week with 80% accuracy, two to three weeks in advance. With a lead time of four weeks, it was able to get within one colour either side 90% of the time. These results were better than existing methods, despite the fact that predictions were for the whole state while two-thirds of the traders were concentrated in the eastern part of it, near the university.

This year, the researchers plan to expand the experiment by recruiting more participants over a larger area of Iowa, in order to see if they get better prediction data. If that works, the market will

be expanded to cover the whole country.

The most successful trader, meanwhile, was able to pocket $213. Not a fortune, perhaps, but a rate of return on a $100 stake that might be envied by a trader in a real financial market.

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Deforestation and floods

Not the root cause

Oct 13th 2005
From The Economist print edition

Economic growth, not tree felling, is to blame for disastrous floods

Get article background

EVERY year, massive floods cause misery to millions of people living in Bangladesh, Cambodia, China, India, Thailand, Vietnam and elsewhere in the Asian lowlands. Politicians and environmentalists alike commonly attribute such disasters to the clearing of Asia's upland mountain forests. But this blame is unfairly attributed, according to a United Nations report published this week.

Conventional wisdom says that forests prevent flooding by acting as giant sponges. Tree roots, the forest soil and leaf litter soak up water during heavy rainfall, delaying or even altogether preventing its arrival in nearby watercourses. Contrary to such popular belief, the report says, in reality the forests have only a limited effect on major floods. It is true that, on a local scale, trees can reduce the volume of water arriving in nearby streams and rivers, or at least, spread its arrival over a greater time span. However, this holds true only for relatively short periods of light, drizzly rain over small areas.

If the rain is heavy, prolonged and falls over larger areas, the presence of trees will not prevent catastrophic floods. This is because, when major floods do occur, it is most often towards the end of the rainy season, when heavy rain falls on areas that are already waterlogged. That is to say, the giant sponge that is the forest has already become saturated.

Under these circumstances, flooding is unavoidable. Indeed, not only is it impossible to prevent such flooding, but doing so would lay waste some of the benefits of becoming temporarily waterlogged. Flooding is important for maintaining biodiversity and preserving fish stocks. It also replenishes the fertility of flood plain soils. Farmers in many flood plains plant crops that grow underwater, such as deep water aman rice or jute.

AP

The report's numerous authors also attack claims that the presence of trees prevents catastrophic landslides. It is true, they say, that tree roots can trap sliding soil but only for shallow landslides of up to a metre in depth. If the slipping soil is deeper than three metres, the presence of trees will not be sufficient to stop the slide.

The report, “Forests and floods: drowning in fiction or thriving on facts?”, was compiled by researchers based at the Centre for International Forestry Research—a research institute based in Bogor, Indonesia, dedicated to forest conservation and human welfare—working with a host of other international teams. It

was published in collaboration with the UN's Food and Agriculture Organisation.

The problem is not a lack of trees

So, if the removal of the forests from the mountains whose rivers feed the coastal cities is not to blame for disastrous floods, what is? The report contends that the main cause of the damage is the growth in the human population and associated economic activities. Towns and cities have long been established on flood plains, despite the risk of periodic flooding. This is because the numerous social and economic benefits of living near water tend to outweigh the risk. Historically, such settlements have clung to the higher ground on the flood plain. But as towns and cities have grown, new housing estates and commercial zones have been built on ever more flood-prone areas.

The flooding of the Yangzi river in China in 1998 caused $30 billion-worth of damage. Further floods in 2000 in Cambodia and Vietnam caused $145m and $285m, respectively. Globally, floods affect the personal and economic fortunes of more than 60m people every year.

Yet measuring the severity of floods in terms of economic losses rather than the geographical extent of the waters can give the impression that flooding has become much more severe in recent times. In reality, the huge economic losses attributed to flooding in recent years are mainly a reflection of economic growth, increased investment in infrastructure and rapidly growing flood plain populations. Floods are no more frequent today than they were 120 years ago, when lush forests were abundant. The problem is just that more people now live and work on flood plains.

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Economist.com SCIENCE & TECHNOLOGY

Racing robots

Stanley rides again

Oct 13th 2005
From The Economist print edition

Stanford Racing Team

This year's Grand Challenge race actually produced a winner

LAST year, America's Defence Advanced Research Projects Agency, DARPA, thought it would be a wizard wheeze to organise a robot race across the Nevada desert. The idea of the Grand Challenge, as DARPA grandiosely dubbed it, was for autonomous robot vehicles to steer a 227km (142-mile) course and claim a $1m jackpot. This would be a first step towards DARPA's ultimate goal of being able to build unmanned self-driving military vehicles and thus keep American troops out of harm's way on the battlefield.

At the time, the Grand Challenge seemed an embarrassing flop. None of the 13 entrants finished. Indeed, none got more than 12km from the starting line. But, if at first you don't succeed, try, try, try again. And 18 months after the first Grand Challenge ended, the second one set off on October 8th.

This year's crop of 23 entrants were offered an even greater incentive—a $2m prize for the winner. That, plus the intervening 18 months, seems to have done the trick. This time, five vehicles finished the 211km course. The winner, a modified Volkswagen Touareg dubbed Stanley by its makers, a team from Stanford University, did it in a mere six hours and 54 minutes.

Stanley was, of course, specially hardened by its designers for the rough terrain of the Nevada desert. The clever bit, however, was the vehicle's brain. This was designed and built by the Stanford Artificial Intelligence Laboratory (SAIL).

Stanley's brain consists of six top-of-the-range Pentium chips wired collaboratively together. It is programmed with special software that is able to learn from its mistakes. This software mastered the tricks of collision-avoidance in a series of desert test runs conducted before the race started.

Like all brains, Stanley's has a range of sensory inputs to process. A global positioning system

(GPS) receiver tells it where on the Earth's surface it is. Television cameras, radar and four laser-based distance monitors tell it what its surroundings are like. By comparing its GPS location with its pre-programmed destination (announced only a few hours before the race began, to avoid shenanigans), it knew which way it wanted to go. And, by studying its surroundings, it could work out what looked like the safest route that was also in approximately the right direction.

Although Stanley carried off the laurels, the other four finishers did respectably. Sandstorm managed a time just ten minutes behind the winner while her sister vehicle H1ghlander came in ten minutes after that. GrayBot and TerraMax, the other two course-completers, came in at seven hours 30 minutes and 12 hours 51 minutes, respectively.

So smart, autonomous vehicles can, indeed, find their way across several hundred kilometres of desert. The question is, what next? DARPA's answer, of course, will be to go down the military route. But this sort of technology has obvious civilian applications as well, as Sebastian Thrun, the head of both SAIL and the Stanford racing team, is keen to emphasise.

Dr Thrun thinks that it could lead to self-driving road vehicles within 30 years and—more immediately—to greatly improved collision-avoidance systems. Whether the freeways of California will prove as easy to navigate as the gulches of Nevada, though, remains to be seen.

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Iraq

Big problems

Oct 13th 2005
From The Economist print edition

AP

A once-hopeful reporter turns to painful questions about the war

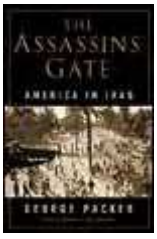
NO ONE who reads this book, however fervent a supporter of the war to topple Saddam Hussein, can avoid concluding that the campaign to make Iraq a better place has been one of the worst planned and executed in American history.

George Packer's brutal analyses and trenchant on-the-spot reportage for the *New Yorker* magazine over the past two years provide the core of this devastating critique. It re-confirms the now familiar but appalling facts: that once the Americans' high-tech military superiority had rapidly overwhelmed Mr Hussein's force in the conventional phase of war, there was, amazingly, no plan whatsoever for the future, beyond a sublime belief in the assurances of a coterie of Iraqi exiles that harmony ("sweets and flowers") would magically replace the dictatorship. It is a tale of arrogance and ignorance, made worse by a blind refusal of those who drove the idea to admit that things were going awry until it was too late.

But this is no partisan rant. Mr Packer is a friend and admirer (perhaps, today, a more qualified one) of Kanan Makiya, a courageous long-time Iraqi exile now often in Baghdad, who alerted many people in the West to the full horror of Mr Hussein's regime with his 1989 book, "Republic of Fear: The Politics of Modern Iraq".

"I belonged to that tiny, insignificant, ambivalent camp of pro-war liberals who supported a war by

The Assassin's Gate: America in Iraq
By George Packer



Farrar, Straus and Giroux; 450 pages; $26.
To be published in Britain by Faber and Faber in February

Buy it at
Amazon.com

about the same margin that the voting public had supported Al Gore," writes Mr Packer, citing with approval previous humanitarian interventions in Haiti, Bosnia and Kosovo. "I wanted to see Iraqis let out of prison; I wanted to see a homicidal dictator removed before he committed mass-murder again; I wanted to see if an open society stood a chance of taking root in the heart of the Arab world."

Mr Packer brilliantly describes the evolving mindset of the neo-conservatives who took hold of policy towards Iraq in the run-up to war, as well as the hopes and arguments of their assorted Iraqi allies in exile. One of the first of many tragic mistakes was the success of the Pentagon and Donald Rumsfeld in excluding virtually anyone who actually knew Iraq and the Arab world or spoke Arabic. None of the leading figures in the administration, then or now, emerges with any credit, including Colin Powell, Dick Cheney, Paul Wolfowitz, Mr Rumsfeld or Condoleezza Rice; by implication, the president was entirely led by an inner circle of tunnel-visioned ideologues and weak-kneed sycophants.

The administration was paralysed by what Mr Packer calls an attitude of "groupthink", whereby no one dared to question the basic assumptions that the war would be over quickly and that Iraq would soon recover, once the Baathist monstrosity had been destroyed. For one thing, nation-building, in Mr Rumsfeld's earlier view, was unnecessary; American forces would be in and out in a matter of months. Consistency was another casualty of war. Four months after it began, Mr Rumsfeld said there was "no guerrilla war". He might not say so now.

A particularly telling example of unpalatable advice ignored was when General Eric Shinseki, the army chief of staff, said that an occupying army of several hundred thousand would be needed to pacify the country, rather than the 100,000 or so at first deemed likely to be needed for a short time and then rapidly wound down. He was scoffed out of court. "This controversy [over troop numbers] didn't survive your first contact with Iraqi reality," writes the intrepid Mr Packer, who covered thousands of miles of Iraq in his trips in and out of the country and managed to talk to hundreds of Iraqis from all walks of life.

Much of this is old hat, previously described by Mr Packer in the *New Yorker* and by others elsewhere. Where he scores most is in portraying the psychology of Iraqis, their ambivalence to the liberation/occupation ("I wanted both sides to lose," says one quite typical Iraqi doctor), their fractiousness and fatal vulnerability to absurd conspiracy theories, as they try to creep out from under the debilitating shadow of Mr Hussein. Mr Packer empathises with them in all their diversity, drawing a remarkable cast of sharply defined characters; sadly, it would be almost suicidal for him, today, to have many of those revealing meetings across Iraq. In the end he appears to endorse the words of a British Arabist in the coalition administration, who says: "No foreigner really knows what's going on in Iraq."

The technique that the author deploys with fine effect is to tell his tale through the eyes of a score or so of participants, American and Iraqi, many of them quite humble: a captain in the American army; an Iraqi psychiatrist; the father of a dead American soldier; a young, idealistic, female Iraqi translator who turns out, secretly, to have Jewish ancestry; a bevy of frustrated officials in the hopelessly incompetent Coalition Provisional Authority that ran Iraq for the first year after the invasion.

It is not clear whether Mr Packer now thinks the American adventure doomed or rescuable. "The Iraqi war was always winnable; it still is," he writes, echoing the thoughts of one of the book's idealistic Americans who worked in Baghdad. "For this reason, the recklessness of its authors is all the harder to forgive." But his pay-off line is less tentatively optimistic, quoting his visionary friend, Mr Makiya, who says of himself: "I embody the triumph of hope over experience." A second book, to round off the tale in a year or two, is certainly due; Mr Packer might then be ready to decide whether the war was worthwhile.

The Assassin's Gate: America in Iraq.
By George Packer.
Farrar, Straus and Giroux; 450 pages; $26.
To be published in Britain by Faber and Faber in February

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The Middle East

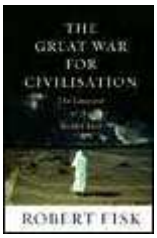
Bigger problems

Oct 13th 2005
From The Economist print edition

EPA

Dangerous deceits

The Great War for Civilisation: The Conquest of the Middle East
By Robert Fisk



Knopf; 1366 pages; $40.
Fourth Estate; £25

Buy it at
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IN THE course of 30 years as Middle East correspondent for two London newspapers, the *Times* and the *Independent*, Robert Fisk has filled a lot of notebooks with a lot of stories. Many of them are excellent. His new book begins with a ripping yarn about his summons in 1996 to interview Osama bin Laden. Setting up the encounter takes many months. The process opens with an intermediary's call to “Mr Robert's” office in Beirut. It continues with a mysterious meeting in London's Belgravia Sheraton hotel, moves via New Delhi to a flight into Jalalabad's old Soviet military airstrip, pauses for a sweaty interlude in the Afghan city's Spinghar hotel and culminates, after an edgy night drive with machine-gun-toting escorts, in an interview with Mr bin Laden at a remote mountain hideaway.

Mr Fisk is a gifted writer and an accomplished storyteller, so those who have not read him before will enjoy the famous correspondent's colourful narrative. Mr Fisk tries to tell the story of the Middle East, but he does not flinch from telling the story of Mr Fisk. So here is not only a record of what he has seen and reported since 1976 in Afghanistan, Lebanon, Iraq, Iran, Algeria and many other dusty and violent places, but also a tale of how he got the lead, wangled the flight, bribed the guard and brought home the scoop. The *Times* offered Mr Fisk the Middle East when he was only 29, and his love affair with the region and the glamorous profession of being a foreign correspondent finds expression on every page.

Over the years, the vividness of his reporting and the vehemence of his opinions have turned him into one of Britain's most controversial journalists. Two decades ago, in a history of Lebanon's civil war, he argued that the job of the journalist was to write a first draft of history. Since then, he appears to have changed his mind. In the preface of this book he endorses the view of an Israeli journalist, Amira Hass, that the proper vocation of the reporter is to “monitor the centres of

power”. The upshot is that the chief villains in his stories from the Middle East are governments, mainly those of the West which he believes have been led by folly or knavery to meddle needlessly in the affairs of a region not their own, and which have almost invariably turned out to make a bad situation worse.

People who buy the *Independent* mainly to read Mr Fisk's Old Testament rants against the wickedness of Israel and America will love this book. But is it possible to loathe this point of view and still enjoy the read? Up to a point. For even if you are turned off by Mr Fisk's self-righteous identification with those he deems history's victims—and this habit's subtle corollary of making himself the hero of every story—he still repays reading. All you have to do is skip the analysis and tuck into the wealth of hard-won narrative detail accumulated over the decades of intrepid reporting. With Mr Fisk you meet the grim Russian crews threading their tanks through Afghanistan's mountain passes in 1980; sit at the feet of Sadeq Khalkhali, the Iranian revolution's “hanging judge”; witness the Israelis' Merkava tanks clattering into downtown Beirut in 1982; and join Ayatollah Khomeini's Revolutionary Guards in their fearless, doomed assaults on Iraqi lines in 1987.

The trouble with reading the reporter and ignoring the polemicist is that only some of this book consists of reporting. Mr Fisk interleaves his first-hand accounts with much material of more doubtful quality: potted histories (of the Palestine conflict, the Suez crisis of 1956, the Armenian genocide) and warmed-up off-cuts from old columns (denouncing the George Bushes junior and senior, Tony Blair and the supposedly supine reporting of CNN, the *New York Times* and sundry other media that happen not to subscribe to the full Fisk world view). As a result, the whole is worth rather less than the sum of the parts.

When Mr Fisk at last conducts his interview with Mr bin Laden on that bare Afghan mountain in 1997, the Saudi son of a billionaire, who later commends him as a rare western reporter who is “neutral”, says: “Mr Robert, from this mountain upon which you are sitting, we broke the Russian army and we destroyed the Soviet Union. And I pray to God that he will permit us to turn the United States into a shadow of itself.” Four years later, when the hijacked airliners glide into New York's twin towers, Mr Fisk recalls this warning and dictates a column—reprinted in full in his book—in which the perpetrators are described as representatives of a “crushed, humiliated population” who are “striking back”.

The Middle East, Mr Fisk believes, is a region of victims, and the terrorism it generates is the enraged lashing out of the powerless. Seeing the region this way gives his writing its force. But it also produces systematic distortion. Mr Fisk seems unwilling to find the slightest hint of rhyme, reason or justification in the behaviour of the powerful—especially America and Israel—lest doing so is allowed to blunt his righteous anger. So he quarrels not only with America's invasion of Iraq but also with its invasion of Afghanistan. Israel's violence is invariably “brutal” or “ruthless” as it pursues “the last colonial war”.

As for the American idea of spreading democracy, Mr Fisk says that Arabs also want “justice, a setting-to-rights, a peaceful but an honourable, fair end to the decades of occupation and deceit and corruption and dictator-creation”. But hang on. The Israeli occupation of the West Bank and Gaza came about because in 1967, as in the decades before, the Palestinians and Arab states were intent on liquidating the Jewish state; and the Arab dictators—the Nassers, Saddams and Assads—were created at home, not abroad. The extent to which Arabs have been the authors of their own misfortune is not given adequate consideration in this dogged, powerful and often infuriating polemic against the West.

The Great War for Civilisation: The Conquest of the Middle East.
By Robert Fisk.
Knopf; 1366 pages; $40.

Fourth Estate; £25

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Economist.com BOOKS & ARTS

Managing “knowledge workers”

Brain teasing

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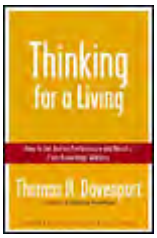
IN THE early industrial age, men in white coats would walk around factories with watches and clipboards measuring the time it took workers to perform specific tasks. These “time-and-motion” experts set out to measure labour productivity, and thence to improve it. The sort of jobs they were measuring, however, no longer enjoy such a premium in the places where they measured them: less than 10% of today's jobs in America are in manufacturing, and less than 15% of those in Britain.

Workers of the western world are now employed largely in service industries, where they are paid for their brain rather than their brawn. Many of them can be called “knowledge workers”—between a quarter and a half, estimates Thomas Davenport, who is a long-time observer of the species.

Knowledge workers, he says, are those whose “primary tasks involve the manipulation of knowledge and information.” These people are the creators of wealth in western economies today, yet scarcely anybody is measuring their output and seeking ways to improve it. Somebody should, Mr Davenport argues. Finding ways to improve the productivity of knowledge workers, he says, is “one of the most important economic issues of our time”. He is not the first to say this. Peter Drucker, who invented the term “knowledge worker” more than 35 years ago, said then that “management's new role” is to “make knowledge more productive”.

Thinking for a Living: How to Get Better Performance and Results from Knowledge Workers
By Thomas H. Davenport



Harvard Business School Press; 240 pages; $27.50

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Amazon.com
Amazon.co.uk

Little has happened in the intervening time, partly because this is not an easy task. There are no time-and-motion studies that can measure how many thoughts go through knowledge workers' heads or the value of their creative output. Does that therefore mean that companies must (as most of them have until now) leave these valuable assets entirely to their own devices, to work as each of them sees fit while they, their employers, merely stand and wait?

Mr Davenport shows that the answer to this question does not have to be yes. Some companies have tried to make their knowledge workers more productive. Hewlett-Packard, for instance, was one of the first to create a sort of electronic “yellow pages” directory of experts inside the company, together with their expertise. Research has found that the computer programmers with the biggest offices are the most productive, and that e-mail is a better medium for complex negotiations than instant messaging.

By looking at the ways in which different workers use knowledge, Mr Davenport begins to build a framework within which companies can start thinking about how to make the process more productive. It is not yet—and may never be—a very tidy framework, and it ranges from the best technologies that gather and disseminate information which knowledge workers need, to the sort of workspace best suited to people who are very mobile and who, by definition, need to

concentrate a lot. But it is a bold attempt to address a pressing issue. What a pity that the author felt the need to conform with formulaic management books and end each chapter with a “summary” and a number of blobbed “recommendations”. Knowledge workers don't like being patronised; Mr Davenport should know that.

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Harvard Business School Press; 240 pages; $27.50

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The Man Booker prizewinner

From the deep

Oct 13th 2005
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THIS was meant to be such a hot year for new fiction in English that the judges of the Man Booker prize insisted they could have produced not just the usual six-volume shortlist, but a version of 12 books, any one of which could have proved a worthy winner.

Which is why it came as such a surprise to hear John Sutherland, the chairman, announce in a downbeat voice on Monday night that the £50,000 ($87,320) cheque would go to John Banville, a 59-year-old Irishman whom many thought was the season's rank outsider.

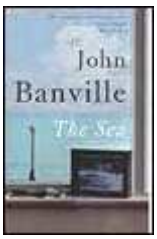
“The Sea”, Mr Banville's 14th novel, features an ageing art historian, Max Morden, who returns to a seaside village where, as a boy, he had once spent a holiday, and muses over grief, memory and love recollected. There is really very little plot.

Instead, the book's strength lies in its language: not just the extra-terrestrial words, “flocculent”, “crepitant”, “velutinous”; or the colourful phrasing—a woman's post-chemotherapy hair is like “a cat's licked fur”, a landlady's eye imbued with a “fishy swivel”—but Mr Banville's particular Hiberno-English. As Max crumbles, his thoughts and memories seem physically to swell within him, expressed in sentences that are ever expanding—with another clause, another adjective, another assonance being added to the travelling wave. In lesser hands, this would drain away in a swirl of over-writing. Instead, Mr Banville's style affords the reader a voluptuous, unfashionable pleasure that grows with every re-reading of the book and casts the story with ease into second place.

In London, Mr Banville's win was hailed with mixed feelings; in his native Ireland, he is being treated as a conquering hero. Had the Booker existed then, no one in 1922 would have picked another triumph of idiom, James Joyce's “Ulysses”. Yet look how that has lasted.

The Sea.
By John Banville.
Picador; 264 pages; £16.99.
To be published in America by Knopf on November 8th

The Sea
By John Banville



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Economist.com BOOKS & ARTS

Laurence Olivier

Seeing red about the man in black

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WHEN a legendary figure has been dead for 16 years, a revisionist biography is welcome. Laurence Olivier was a great actor on stage and screen, a brilliant director and producer of films of Shakespeare plays, first director of Britain's National Theatre and a glamorous show-business celebrity. But the revisionist view of Olivier has not appeared in Terry Coleman's book. It is to be found in the reviews of it. The most brutal of these, by Garry O'Connor in the *Evening Standard*, a London newspaper, describes Olivier as “ultimately, a great ham”.

Olivier: The Authorised Biography
By Terry Coleman

Henry Holt; 608 pages; $32.50.
Bloomsbury; £20

Buy it at
Amazon.com
Amazon.co.uk

Mr Coleman's exhaustive biography, based on papers in the British Library archive, is authorised by the family. But that does not mean he is sycophantic. Peter Hiley, who was an intimate associate of Olivier's, is quoted as saying that the actor was snobbish, single-minded and ruthless. Sir John Gielgud had his reservations: “Brilliant, but his gift for mimicry as opposed to creative acting stuck in the gizzard at times.” Mr Hiley declares that Olivier was not a deep man: “Larry was not really interested in people, you see. He would observe someone, think it would make a good something for Shylock, but he was picking up mannerisms, he wasn't wondering what the person was like.”

Mr Coleman, however, refers to Olivier's “instinctive conviction that he did not just play a character but became that character.” His performances were often unforgettable—his Henry V and Richard III on film, his Othello and his Archie Rice in John Osborne's “The Entertainer” on stage. There was a bold theatricality about his work that contemporary actors might consider over the top. Olivier, who was fond of sexual metaphors, said that acting was “coming for a living”.

Perhaps he did belong to an earlier tradition. He was compared to the great Victorian actor, Sir Henry Irving, who was capable of mesmerising an audience. (Irving was the first actor to be knighted; Olivier the first to become a lord.) Offstage, Olivier's life was often pure melodrama. His glamorous second wife, Vivien Leigh, was a manic depressive, and Mr Coleman's accounts of her madness are harrowing. One episode, which began in Hollywood, required violent physical restraint on the journey back to London, where she was given electric shock treatment. Afterwards, Olivier wrote: “She was not the girl I had fallen in love with.”

Mr Coleman's critics accuse him of failing to analyse Olivier's state of mind, though he enables his readers to do so for themselves. Anthony Holden (an earlier biographer), in the *Observer*, cannot forgive Mr Coleman for failing to agree with him that Olivier had a homosexual affair with Danny Kaye. On the other hand, Mr Coleman does come up with evidence that Olivier had a fling with an actor named Henry Ainley. Some critics then accuse him of removing sexually explicit language from Ainley's letters.

Others deplore Mr Coleman's disinclination to analyse the magical quality in Olivier's

performances; or, as Mr O'Connor would have it, the absence of it. But Mr Coleman is a journalist, a facts-man, and he has used original material from the archive to produce the best-documented and most convincing account of Olivier's life so far. For the revisionists, many of whom would have liked to write this biography themselves, that is not enough. It is hard not to feel a little sorry for him.

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By Terry Coleman.
Henry Holt; 608 pages; $32.50.
Bloomsbury; £20

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New films

A female firmament

Oct 13th 2005
From The Economist print edition

Hollywood's women are triumphing on-screen this autumn

No dumb blonde

SOMETIMES it is hard to keep a good girl down. Hollywood actresses have produced a wave of wonderful performances recently, even on the back of screenplays that range from fluffy to worse.

Reese Witherspoon's sweetheart status can only be enhanced by “Just Like Heaven”, which opened in America last month and is due out in Europe over the coming weeks. Once again, a stressed-out career woman gets back to basics with the help of a man who doesn't shave. Elizabeth (Ms Witherspoon) is so bleary-eyed from 24-hour rounds at the hospital where she is doing her residency that she skids on a rain-slick motorway while changing a tape and collides with a truck.

This is a challenging way to begin a romantic comedy. A bereaved wreck named David (Mark Ruffalo) then sublets Elizabeth's flat, only to find that it is still inhabited by Elizabeth, who is infuriated at his habit of not using coasters when downing his daily six-pack. “I'm seeing someone,” David tells his friend and therapist Jack (Donal Logue), who is delighted. “You don't understand,” he insists. “I'm seeing someone who's not there.”

Directed by Mark Waters, “Just Like Heaven” stays sweet and funny all the way through to a suspenseful climax that would have sent a lesser effort falling headfirst into a certain high-profile cultural divide that opened under the filmmaker's feet even as the film was being shot. (To say more would give away an essential plot point.) Happily, Ms Witherspoon's winning performance as a control freak finding love in the last extremity keeps the soufflé from collapsing.

“In Her Shoes”, which has also just been released in America and opens in Britain next month, aims higher but misses. Based on Jennifer Weiner's best-selling novel, the film is excellent when portraying the lifelong disconnect between two loving sisters: Maggie (Cameron Diaz), a kleptomaniac with no fixed employment and a fondness for one-night stands, and Rose (Toni Collette), who has nothing in her life but her job in a law firm. The two women share the same shoe size, but this only adds to the friction: Rose has a collection that Imelda Marcos would envy, and Maggie likes helping herself. When she compounds her crime by stealing Rose's first man in years, she flees her sister's wrath and takes refuge with the grandmother neither knew she had, which introduces a third powerhouse actress: Shirley MacLaine.

After making scarcely a wrong move for the first hour, Curtis Hanson, the director, rarely makes a right one. Despite this, his trio of actresses comes through with brio. The performances of both Ms Diaz and Ms Collette could not be bettered, despite matched contrivances that require Maggie to conquer dyslexia by learning bad poetry and Rose to give up her stressful career for love and

marriage.

Ms MacLaine is shrewd and subdued as the grandmother and Norman Lloyd (who played the title character in Hitchcock's “Saboteur” more than 60 years ago) is in fine dry form as Maggie's blind, expiring tutor. Never mind that the film is not another “Terms of Endearment”; see it for the ladies, if for nothing else.

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Economist.com PEOPLE

Leo Sternbach

Oct 13th 2005
From The Economist print edition

Roche

Leo Sternbach, inventor of Valium, died on September 28th, aged 97

EVER since man arrived on the planet, or at least since his expulsion from Eden, he has looked for ways to soothe the anxieties and pains of life. The ancient Greeks, when brand-new democracy got too much for them, knew the calming oblivion of eating the lotus or sipping nepenthe. The industrial and French revolutions, which produced anxiety on a vast scale, saw De Quincey on opium, Coleridge on laudanum and Davy, in his chemical laboratory, giggling and whooping helplessly as he sniffed nitrous oxide gas.

All these things helped somewhat. But it was not until the second half of the 20th century, when material comforts ceased to satisfy and the wheels of human life seemed stuck in fast-forward for ever, that the search began in earnest for a simple way to make existence bearable. Simple, and safe: for the problem with all tranquillisers up till then, from henbane and absinthe to barbiturates, was that they gave unpleasant side effects at moderate doses and, at larger ones, killed you.

Leo Sternbach, in 1954, was ordered to find such a medicine. His employer, Hoffman-La Roche, was in a race with Wallace Pharmaceuticals. Wallace had already brought out a pill, Miltown, which worked fairly well to calm the agitated. Mr Sternbach's job was to find a compound just as good, or better, with just enough differences to get round Wallace's patent.

To Mr Sternbach, tinkering with someone else's drug was a dull sort of job. He loved chemistry with a passion, and had done so ever since, as a teenager in Poland, he had tipped the powder out of first-world-war artillery shells and made it into fireworks. Chemistry, he also believed, could help people. As a pharmacist's son, serving in the shop, the usefulness of getting deep into molecules and compounds was made clear to him every day. He was not interested in commercial

rivalry, but in discovering how matter worked.

In his wilful way (“I always did just what I wanted to do,” he said later), he turned to research he had started as a student, at Krakow University, into a class of compounds called benzodiapenes. At the time, he had thought he might make synthetic dyes with them. But he had always suspected they might interact with the central nervous system of human beings.

Over two years, he tested 40 compounds. They turned out to be pharmacologically inert. Hoffman-La Roche, which had spent much money and effort to bring him and his wife safely over from anti-Semitic Europe to New Jersey in 1941, drummed its collective fingers with impatience. In 1956 Mr Sternbach, fiddling with yet another benzodiazepine, treated it with methylamine, made a white crystalline powder, labelled it Ro 5-0690 and put it away on a shelf. He was ordered to stop messing about, and to develop antibiotics instead.

He was well aware, however, that he had made something interesting. When he tested the powder on mice they no longer ran up a steep incline to get a reward, nor tumbled down it in a stupor, but ran around, happy and alert, at the bottom, as if the rat-race did not exist. Under pretence of finding it accidentally, and being about to throw it away, Mr Sternbach took his powder to the head of pharmacology for testing. He, too, was excited to see the way the mice behaved. Cats relaxed when dosed, and nervous old folk became tranquil, with no side effects.

A little yellow pill

The new drug, named Librium, was approved for use in 1960. Three years later a simpler version, several times stronger, was developed by Mr Sternbach and called Valium. This became astonishingly popular. Between 1969 and 1982, it was the most prescribed drug in America; in its peak year, 1978, 2.3 billion went down American throats.

Fame brought notoriety. The Rolling Stones sang about Valium as “Mother's Little Helper” (“And though she's not really ill,/There's a little yellow pill”). Its addictiveness was exposed, though not proved harmful, on “60 Minutes”. Stars competed to admit their dependence. Elizabeth Taylor said she swallowed hers with Jack Daniels; Tammy Faye Bakker took hers in conjunction with nasal spray. Elvis was a compulsive user. All this did damage, but Mr Sternbach leapt to Valium's defence. Think, he said, of the suicides it had averted and the marriages it had saved.

Besides, there was more to his work than tranquillisers. He claimed 241 patents, including Mogadon, a sleeping pill, and Klonopin, for epilepsy. These discoveries helped to turn Hoffman-La Roche into a giant of the pharmaceutical industry. Mr Sternbach himself got a dollar for each discovery (paid for resigning the patent rights), and several times won a prize of $10,000 for a profit-making invention, until the company judged he had won it enough. Money never bothered him, for he had no ambitions outside chemistry. He went into the office until he was 95, just to keep up with what was going on.

In the best traditions of chemists like Davy, he dosed himself with his own stuff. One substance gave him such hallucinations that he had to sleep them off for two days. Librium, he said, made him feel very tired, and Valium made him depressed. When life got too much (as it seldom seemed to), he preferred Scotch.

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Overview

Oct 13th 2005
From The Economist print edition

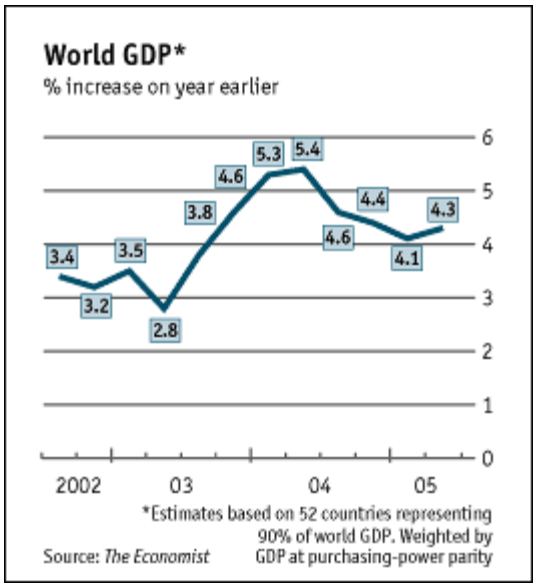
In **America**, 35,000 workers were dropped from non-farm payrolls in September, far fewer than analysts had expected after Hurricane Katrina. It was nonetheless the first time the economy has shed jobs in over two years. The unemployment rate rose to 5.1%, up from 4.9% in August. Without the storm, the Bureau of Labour Statistics reckons that payroll employment would have followed the monthly average gain of 194,000 jobs in the year to August.

Japan's Nikkei stockmarket index jumped by 2.5% on October 11th, its biggest daily gain in a year, following a surge in capital spending. Core private-sector machinery orders, which exclude those for ships and from electric power companies, rose by 8.2% in August, beating economists' forecasts.

Industrial production in the **euro area's** two largest economies was mixed in August. **France's** industrial output expanded by 0.8%, compared with a fall of 0.9% in July. Production in **Germany** contracted by 1.6%, compared with an increase of 1.2% in the previous month.

The number of people unemployed and claiming benefits in **Britain** climbed by a higher-than-expected 8,200 in September. August's claimant count was revised upwards from 1,600 to 2,700. Average earnings increased by a steady 4.2% in the three months to August over the previous year, allaying fears that inflation may be seeping into wages. Meanwhile, producer prices rose by 3.3% in the year to September, compared with 3.0% in the year to August, mainly due to the higher cost of petroleum products.

The Economist's **world GDP** indicator grew by 4.3% in the year to the second quarter, down from 5.4% in the same quarter of 2004.



Output, demand and jobs

Oct 13th 2005
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2005	2006	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 2.6	Q2	+ 5.2	+ 2.6	+ 3.3	+ 0.7	Q2	+ 1.6	Q2	5.1	Sep	5.5
Austria	+ 2.1	Q2	+ 1.8	+ 1.8	+ 2.0	+ 5.4	Jul	– 1.5	Jul	5.2	Sep	4.9
Belgium	+ 1.5	Q2	+ 1.2	+ 1.3	+ 1.7	– 2.3	Aug	+ 6.7	Jul	13.5	Aug†	13.2
Britain	+ 1.5	Q2	+ 2.0	+ 1.9	+ 2.1	– 1.9	Aug	+ 0.8	Aug	4.7	Aug††	4.7
Canada	+ 2.7	Q2	+ 3.2	+ 2.9	+ 3.0	+ 0.6	Jul	+ 6.7	Jul	6.7	Sep	7.0
Denmark	+ 4.3	Q2	+ 6.6	+ 2.0	+ 2.1	+ 0.1	Aug	+ 4.9	Aug	5.7	Aug	6.4
France	+ 1.3	Q2	+ 0.5	+ 1.4	+ 1.6	+ 2.0	Aug	+ 4.1	Aug	9.9	Aug	10.0
Germany	+ 0.6	Q2	nil	+ 0.9	+ 1.1	+ 2.1	Aug	+ 2.2	Aug	11.7	Sep§	10.7
Italy	+ 0.1	Q2	+ 2.7	nil	+ 0.9	+ 6.1	Aug	– 1.6	Jul	7.7	Jun	8.1
Japan	+ 1.4	Q2	+ 3.3	+ 2.2	+ 2.0	+ 1.6	Aug	+ 3.6	Jun	4.3	Aug	4.8
Netherlands	+ 1.3	Q2	+ 4.9	+ 0.6	+ 1.6	– 0.3	Aug	+ 0.7	Jul	6.6	Aug**	6.2
Spain	+ 3.4	Q2	+ 3.6	+ 3.3	+ 2.9	+ 3.8	Aug	+ 3.1	Aug	9.4	Aug	10.8
Sweden	+ 2.3	Q2	+ 2.6	+ 2.3	+ 2.7	– 4.0	Aug	+ 6.2	Aug	6.5	Aug†	5.5
Switzerland	+ 1.0	Q2	+ 1.1	+ 1.1	+ 1.6	+ 3.9	Q2	+ 1.6	Jul	3.6	Sep†	3.7
United States	+ 3.6	Q2	+ 3.3	+ 3.5	+ 3.2	+ 3.1	Aug	+ 5.0	Aug	5.1	Sep	5.4
Euro area	+ 1.1	Q2	+ 1.2	+ 1.2	+ 1.5	+ 0.5	Jul	+ 2.0	Aug	8.6	Aug	8.9
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 0.2	Q2	– 6.3	na	na	– 3.9	Aug	+ 5.4	Jul	7.2	Aug†	8.0
Greece	+ 3.7	Q2	na	na	na	+ 1.4	Aug	+ 4.0	Jul	9.9	Mar	10.8
Iceland	+ 6.8	Q2	na	na	na	na		na		2.0	Jul†	3.0
Ireland	+ 4.1	Q2	+ 6.5	na	na	+16.6	Aug	+ 4.9	Jul	4.4	Sep	4.4
Luxembourg	+ 3.1	Q1	na	na	na	– 1.5	Jun	– 4.4	Aug	4.5	Aug	4.0
New Zealand	+ 2.6	Q2	+ 4.5	na	na	+ 3.5	Q4	+ 5.9	Q2	3.7	Q2	4.0
Norway	+ 4.8	Q2	+ 5.2	na	na	+ 9.5	Aug	+ 5.1	Aug	4.8	Aug‡	4.5
Portugal	+ 0.5	Q2	+ 4.1	na	na	– 0.8	Jul	– 1.9	Jul	7.2	Q2†	6.3

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ††Jun-Aug; claimant count rate 2.8% in Sep.
§EU harmonised rate 9.0% in Jul. **Jun-Aug.

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Prices and wages

Oct 13th 2005
From The Economist print edition

% change on year ago

	Consumer prices			The Economist poll consumer prices forecast		Producer prices			Wages/earnings		
	latest		year ago	2005	2006	latest		year ago	latest		year ago
Australia	+ 2.5	Q2	+ 2.5	+ 2.6	+ 2.7	+ 6.9	Q2	+ 2.8	+ 5.8	Q2	+ 3.0
Austria	+ 2.0	Aug	+ 2.3	+ 2.2	+ 2.0	+ 1.5	Sep	+ 6.0	+ 2.3	Aug	+ 2.0
Belgium	+ 3.2	Sep	+ 2.0	+ 2.5	+ 2.2	+ 1.8	Aug	+ 5.9	+ 2.5	Jul	+ 2.2
Britain	+ 2.4	Aug*	+ 1.3	+ 2.1	+ 2.2	+ 3.3	Sep	+ 3.1	+ 4.2	Aug†	+ 3.8
Canada	+ 2.6	Aug	+ 1.9	+ 2.3	+ 2.4	– 0.4	Aug	+ 5.5	+ 1.4	Jul	+ 1.5
Denmark	+ 2.4	Sep	+ 1.1	+ 1.6	+ 1.9	+ 5.0	Aug	+ 3.1	+ 2.9	Q2	+ 3.1
France	+ 2.2	Sep	+ 2.1	+ 2.0	+ 1.7	+ 2.8	Aug	+ 2.8	+ 2.9	Q2	+ 2.8
Germany	+ 2.5	Sep	+ 1.8	+ 1.9	+ 1.8	+ 3.6	Sep	+ 3.4	+ 1.3	Jul	+ 0.4
Italy	+ 2.0	Sep	+ 2.1	+ 2.2	+ 2.1	+ 3.7	Aug	+ 3.5	+ 2.9	Aug	+ 2.6
Japan	– 0.3	Aug	– 0.2	– 0.1	+ 0.3	+ 1.7	Aug	+ 1.7	– 3.3	Aug	+ 2.8
Netherlands	+ 1.8	Sep	+ 1.0	+ 1.5	na	+ 5.6	Jul	+ 5.2	+ 1.0	Sep	+ 0.9
Spain	+ 3.3	Aug	+ 3.3	+ 3.2	+ 3.1	+ 4.9	Aug	+ 4.4	+ 3.4	Q2	+ 3.1
Sweden	+ 0.6	Aug	+ 0.6	+ 0.7	+ 1.5	+ 4.2	Aug	+ 2.0	+ 2.5	Jul	+ 3.4
Switzerland	+ 1.4	Sep	+ 0.9	+ 1.2	+ 1.2	+ 1.0	Aug	+ 1.5	+ 0.9	2004	+ 1.4
United States	+ 3.6	Aug	+ 2.7	+ 3.2	+ 3.0	+ 5.1	Aug	+ 3.4	+ 2.6	Sep	+ 2.4
Euro area	+ 2.5	Sep	+ 2.1	+ 2.2	+ 1.9	+ 4.0	Aug	+ 3.1	+ 2.3	Q2	+ 2.1
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 0.9	Aug	+ 0.4	na	na	+ 3.8	Aug	+ 1.8	+ 4.0	Q2	+ 3.8
Greece	+ 3.9	Sep	+ 2.7	na	na	+ 5.5	Aug	+ 4.9	na		na
Iceland	+ 4.8	Sep	+ 3.4	na	na	+ 4.6	Sep	+ 5.2	+ 6.7	Aug	+ 5.2
Ireland	+ 2.3	Aug	+ 2.6	na	na	– 1.1	Aug	– 0.4	+ 3.4	Q2	+ 4.3
Luxembourg	+ 2.9	Sep	+ 2.0	na	na	+ 4.2	Jul	+ 9.8	+ 0.7	Jul	+ 2.2
New Zealand	+ 2.8	Q2	+ 2.4	na	na	+ 4.7	Q2	+ 1.5	+ 2.6	Q2	+ 2.3
Norway	+ 2.0	Sep	+ 1.1	na	na	+17.9	Sep	+20.3	+ 3.8	Q2	+ 4.1
Portugal	+ 2.6	Aug	+ 2.3	na	na	+ 4.4	Aug	+ 4.0	– 0.2	Jun	– 0.1

*RPI inflation rate 2.8% in Aug. †Jun-Aug.

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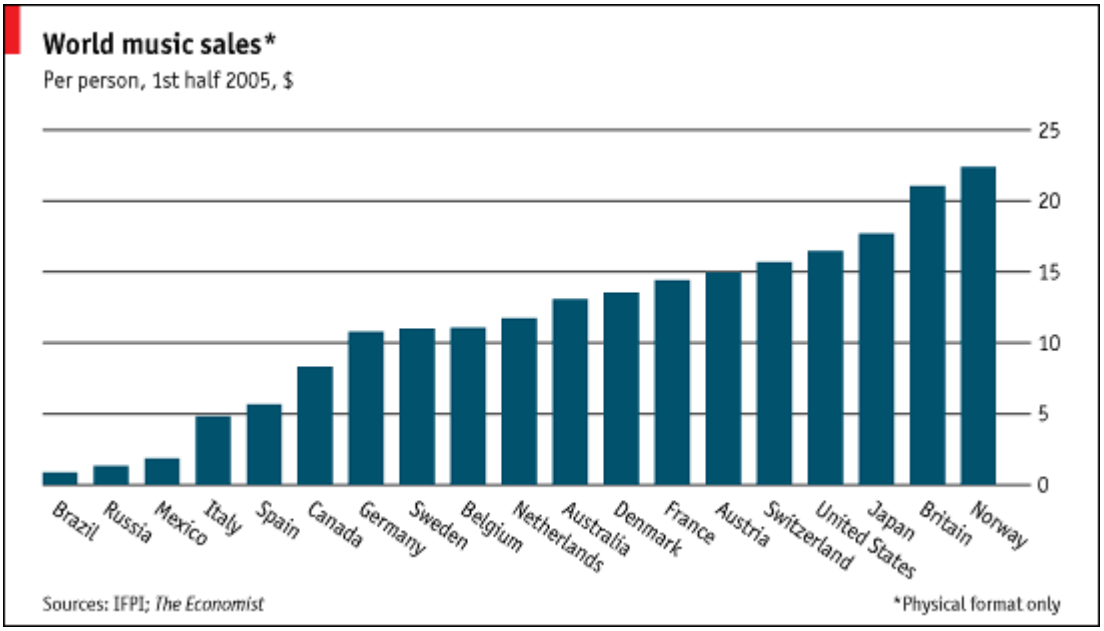
World music sales

Oct 13th 2005
From The Economist print edition

Sales of music CDs and other physical formats fell by 6.3% in the first half of 2005. But sales of digital music (not shown in the chart) more than tripled to $790m. Music downloads and mobile-phone ringtones now account for 6% of retail revenues. Of the countries with the most music sales, the British bought the most per person, thanks to their attractive specialist music shops, and the release of Coldplay's album “X&Y”.



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Money and interest rates

Oct 13th 2005
From The Economist print edition

	Money supply* % change on year ago			Interest rates % a year (Oct 12th 2005)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+ 5.6	+ 8.6	Aug	5.62	5.41	5.30	5.37	5.44	6.31
Britain	+ 6.1	+10.2	Aug	4.50	4.84	4.17	4.32	4.75	5.17
Canada	+ 7.4	+ 9.7	Aug	2.94	2.52	3.41	4.04	4.57	5.13
Denmark	+20.7	+14.8	Aug	2.20	2.25	2.37	3.15	3.96	4.83
Japan	+ 5.2	+ 2.1	Sep	0.02	0.03	0.23	1.53	1.48	1.61
Sweden	+ 2.5	+ 6.2	Aug	1.52	2.04	2.20	3.14	4.19	2.97
Switzerland	+ 0.2	+ 5.6	Aug	0.80	0.72	1.23	1.89	2.49	1.99
United States	+ 1.0	+ 6.1	Aug	3.85	2.00	4.24	4.44	4.08	5.34
Euro area†	+11.5	+ 8.1	Aug	2.19	2.15	2.43	3.19	3.87	3.51

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 4.66%, Japan No. 272 1.54%. Central bank rates: US fed funds 3.75%, ECB refinancing 2.00%, BOJ overnight call 0.001%, BOE repo 4.5%. Sources: Bank of Canada, Commerzbank, Danske Bank, J.P. Morgan Chase, Stockholmsbörsen, UBS, Global Insight, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Oct 13th 2005
From The Economist print edition

2000=100

	Oct 4th	Oct 11th*	% change on one month	% change on one year
Dollar index				
All items	133.8	135.5	+ 2.6	+10.7
Food	123.7	124.3	+ 2.2	+11.0
Industrials				
All	146.9	149.9	+ 3.1	+10.4
Nfa†	135.7	135.8	+ 0.5	+11.2
Metals	153.1	157.6	+ 4.4	+10.0
Sterling index				
All items	115.2	117.7	+ 7.2	+13.4
Euro index				
All items	103.7	104.5	+ 5.1	+13.6
Yen index				
All items	141.8	143.9	+ 6.0	+15.5
Gold				
$ per oz	465.75	476.40	+ 6.7	+15.1
West Texas Intermediate				
$ per barrel	63.85	63.50	+ 0.7	+21.0

* Provisional. † Non-food agriculturals.

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Stockmarkets

Oct 13th 2005
From The Economist print edition

Market indices

	Oct 12th	2005 high	2005 low	% change on one week	% change on record high	% change on Dec 31st 2004 in local currency	% change on Dec 31st 2004 in $ terms
Australia (All Ordinaries)	4,429.4	4,617.4	3,905.5	– 1.5	– 4.1	+ 9.3	+ 5.2
Austria (ATX)	3,350.0	3,503.9	2,415.0	– 2.6	– 4.4	+37.8	+21.9
Belgium (Bel 20)	3,329.1	3,373.8	2,958.8	– 1.0	– 9.6	+13.5	+ 0.5
Britain (FTSE 100)	5,342.2	5,501.6	4,783.6	– 1.6	–22.9	+11.0	+ 1.2
Canada (Toronto Composite)	10,493.1	11,081.2	9,006.2	– 2.4	– 7.9	+13.5	+16.1
Denmark (OMXCB)	338.4	341.9	257.8	– 0.3	– 1.0	+31.3	+15.8
France (SBF 250)	3,158.7	3,248.3	2,633.6	– 1.6	–28.1	+19.9	+ 6.1
(CAC 40)	4,515.1	4,650.2	3,816.1	– 1.7	–34.8	+18.2	+ 4.6
Germany (DAX)*	4,981.8	5,138.0	4,178.1	– 1.7	–38.2	+17.1	+ 3.6
Italy (S&P/MIB)	33,403.0	34,874.0	30,645.0	– 2.1	–33.3	+ 8.1	– 4.3
Japan (Nikkei 225)	13,463.7	13,738.8	10,825.4	– 1.7	–65.4	+17.2	+ 5.0
(Topix)	1,406.9	1,428.1	1,109.2	– 0.2	–51.2	+22.4	+ 9.7
Netherlands (AEX)	393.7	408.7	347.0	– 2.8	–43.9	+13.1	+ 0.1
Spain (Madrid SE)	1,158.5	1,176.9	950.9	– 0.8	– 1.6	+20.8	+ 6.9
Sweden (Affarsvarlden Gen)	267.4	273.7	218.9	– 1.5	–33.2	+20.9	+ 3.4
Switzerland (Swiss Market)	6,919.0	7,042.3	5,669.6	– 1.5	–17.7	+21.5	+ 7.4
United States (DJIA)	10,216.9	10,940.6	10,012.4	– 1.0	–12.8	– 5.2	– 5.2
(S&P 500)	1,177.7	1,245.0	1,137.5	– 1.6	–22.9	– 2.8	– 2.8
(NASDAQ Comp)	2,037.5	2,218.2	1,904.2	– 3.1	–59.6	– 6.3	– 6.3
Europe (FTSEurofirst 300)†	1,204.3	1,242.0	1,038.6	– 2.0	–29.4	+15.6	+ 2.3
Euro area (FTSE Euro 100)†	1,025.8	1,056.1	894.4	– 1.7	–33.8	+13.9	+ 0.8
World (MSCI)‡	1,182.6	1,225.6	1,115.0	– 1.5	–18.4	+ 1.1	+ 1.1
World bond market (Citigroup)††	627.7	662.3	626.3	– 0.1	– 5.2	– 5.8	– 5.8

*Total return index. †In euro terms. ‡Morgan Stanley Capital International Index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Oct 13th 2005
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		The Economist poll % of GDP, forecast 2005	2006	Exchange rate trade-weighted† 2000=100 Oct 12th	year ago	Currency units per $ Oct 12th	year ago	per £	per euro	per ¥100	Budget balance % of GDP 2005‡
Australia	− 16.4	Aug	− 43.1	Q2	− 4.8	− 4.4	118.3	111.6	1.33	1.38	2.32	1.59	1.16	+ 0.9
Austria	− 1.4	Jul	nil	Jul	− 0.4	− 0.6	104.1§	103.9	0.83	0.82	1.46	–	0.73	− 2.0
Belgium	+ 15.4	Jul	+ 9.2	Jun	+ 2.8	+ 2.7	104.7§	104.4	0.83	0.82	1.46	–	0.73	− 0.5
Britain	−115.6	Aug	− 23.5	Q2	− 2.4	− 2.5	98.1	99.2	0.57	0.56	–	0.69	0.50	− 2.9
Canada	+ 46.5	Jul	+ 16.3	Q2	+ 1.6	+ 1.5	123.8	114.1	1.17	1.27	2.05	1.41	1.02	+ 1.2
Denmark	+ 9.8	Jul	+ 9.7	Aug	+ 2.9	+ 2.7	105.7	106.0	6.20	6.06	10.9	7.46	5.43	+ 1.8
France	− 27.1	Aug	− 24.1	Jul	− 0.8	− 0.8	107.3§	106.9	0.83	0.82	1.46	–	0.73	− 3.0
Germany	+200.2	Aug	+110.4	Aug	+ 3.7	+ 3.5	105.1§	104.7	0.83	0.82	1.46	–	0.73	− 3.5
Italy	− 7.0	Jul	− 26.0	Jul	− 1.4	− 1.5	76.8§	76.6	0.83	0.82	1.46	–	0.73	− 4.4
Japan	+104.9	Aug	+163.7	Aug	+ 3.4	+ 3.3	84.0	87.0	114	110	200	138	–	− 6.1
Netherlands	+ 40.0	Jul	+ 28.3	Q2	+ 3.7	+ 3.6	104.2§	103.8	0.83	0.82	1.46	–	0.73	− 2.2
Spain	− 90.6	Jul	− 75.2	Jun	− 6.1	− 6.0	77.4§	77.2	0.83	0.82	1.46	–	0.73	+ 0.5
Sweden	+ 21.4	Aug	+ 27.9	Q2	+ 7.1	+ 6.6	95.8	99.3	7.77	7.39	13.6	9.34	6.79	+ 0.8
Switzerland	+ 7.0	Aug	+ 51.4	Q2	+11.4	+10.9	106.7	106.9	1.29	1.26	2.25	1.55	1.12	− 1.0
United States	−730.7	Jul	−749.7	Q2	− 6.5	− 6.6	86.2	86.1	–	–	1.75	1.20	0.87	− 4.1
Euro area	+ 54.3	Jul	+ 10.3	Jul	+ 0.2	+ 0.2	115.8	116.0	0.83	0.82	1.46	–	0.73	− 2.8
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 12.0	Jul	+ 6.4	Jul	na	na	81.7§	81.5	0.83	0.82	1.46	–	0.73	+ 1.3
Greece	− 33.7	Jul	− 15.7	Jul	na	na	60.0§	59.9	0.83	0.82	1.46	–	0.73	− 3.8
Iceland	− 1.1	Aug	− 1.6	Q2	na	na	105.1**	95.9	61.3	71.1	107	73.7	53.6	+ 1.1
Ireland	+ 40.2	Jul	− 3.9	Q2	na	na	94.6§	93.9	0.83	0.82	1.46	–	0.73	− 0.7
Luxembourg	− 4.4	Jul	+ 3.0	Q1	na	na	104.7§	104.4	0.83	0.82	1.46	–	0.73	− 0.8
New Zealand	− 4.0	Aug	− 8.2	Q2	na	na	138.4	132.7	1.44	1.48	2.52	1.73	1.26	+ 3.2
Norway	+ 43.3	Aug	+ 40.8	Q2	na	na	111.9	106.1	6.49	6.68	11.4	7.81	5.67	+ 14.4
Portugal	− 14.0	Jul	− 15.7	Jul	na	na	93.4**	93.4	0.83	0.82	1.46	–	0.73	− 5.3

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, August average. ‡OECD forecast. **IMF, June average.

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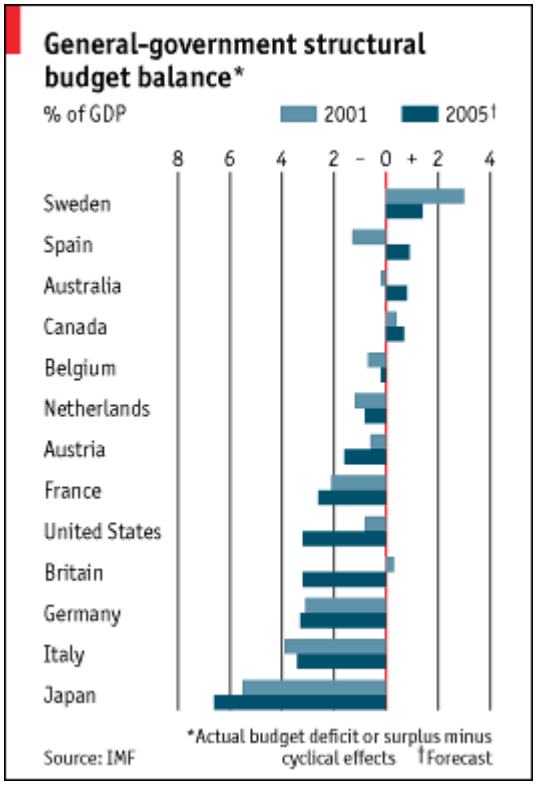
General-government structural budget balance

Oct 13th 2005
From The Economist print edition



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Overview

Oct 13th 2005
From The Economist print edition

China's trade surplus fell to $7.6 billion in September, from $10.6 billion in August, but the 12-month surplus widened to a record $96.4 billion. **Singapore's** GDP growth quickened to 6% in the year to the third quarter, up from 5.4% in the previous quarter.

Turkey's current-account deficit widened to $20.7 billion in the 12 months to August, the biggest deficit of any country in our table (see article).

Egypt's stockmarket rose by another 3.2% this week, to give a total dollar gain of 111% since the start of the year—the strongest performance of any country in the world.

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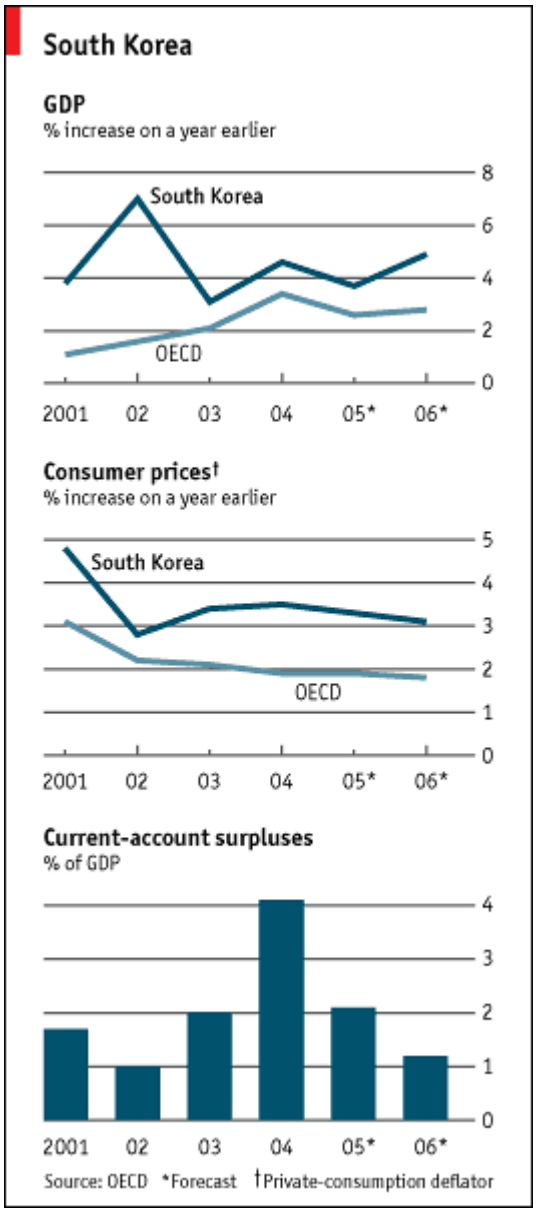
South Korea

Oct 13th 2005
From The Economist print edition

It joined the OECD in 1996, less than a year before the Asian financial crisis derailed its rapid progress towards OECD standards of living. As the organisation notes in its latest survey of South Korea, the reforms prompted by that crisis have transformed the economy. Almost half of the country's big *chaebol* have disappeared, and foreigners today own 42% of listed companies. The country's challenge now is to resuscitate domestic demand, flagging since a credit-card bubble burst in 2002-03.



Economy

Oct 13th 2005
From The Economist print edition

	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 9.5	Q2	+16.0	Aug	+ 1.3	Aug	+96.4	Sep	+68.7	2004	711.0	Jun
Hong Kong	+ 6.8	Q2	– 0.1	Q2	+ 1.3	Aug	– 9.7	Aug	+21.3	Q2	122.3	Sep
India	+ 8.1	Q2	+ 7.4	Aug	+ 3.4	Aug	–34.7	Aug	–16.0	Q2	132.2	Sep
Indonesia	+ 5.5	Q2	+ 7.3	Jul	+ 9.1	Sep	+27.2	Aug	+ 4.0	Q2	29.9	Aug
Malaysia	+ 4.1	Q2	+ 4.1	Aug	+ 3.7	Aug	+24.1	Aug	+18.0	Q2	79.5	Aug
Philippines	+ 4.8	Q2	– 1.1	Jul	+ 7.0	Sep	– 0.7	Jul	+ 2.9	Mar	16.0	Sep
Singapore	+ 6.0	Q3	+11.8	Aug	+ 0.7	Aug	+17.4	Aug	+32.5	Q2	115.6	Sep
South Korea	+ 3.3	Q2	+ 5.5	Aug	+ 2.7	Sep	+25.2	Sep	+19.9	Aug	206.6	Aug
Taiwan	+ 3.0	Q2	+ 5.9	Aug	+ 3.1	Sep	+ 1.7	Sep	+13.3	Q2	253.8	Sep
Thailand	+ 4.4	Q2	+10.7	Aug	+ 6.0	Sep	– 7.3	Aug	– 2.3	Aug	48.2	Aug
Argentina	+10.1	Q2	+ 6.0	Aug	+10.3	Sep	+11.4	Aug	+ 2.8	Q1	24.4	Jul
Brazil	+ 3.9	Q2	+ 3.8	Aug	+ 6.0	Sep	+41.2	Sep	+12.5	Aug	54.6	Aug
Chile	+ 6.5	Q2	+ 4.5	Aug	+ 3.9	Sep	+ 8.9	Sep	+ 0.6	Q2	15.7	Sep
Colombia	+ 5.3	Q2	– 0.2	Jul	+ 5.0	Sep	+ 1.7	Jul	– 0.8	Q2	14.9	Aug
Mexico	+ 3.1	Q2	+ 2.1	Aug	+ 3.5	Sep	– 9.6	Aug	– 8.4	Q2	68.2	Aug
Peru	+ 4.9	Jul	+ 4.6	Jul	+ 1.1	Sep	+ 4.0	Jul	+ 0.4	Q2	12.8	Sep
Venezuela	+11.1	Q2	+ 8.0	Jul	+15.9	Sep	+24.7	Q2	+17.7	Q2	24.7	Jul
Egypt	+ 5.2	Q1	+ 3.3	2004†	+ 4.7	Aug	–10.4	Q2	+ 2.9	Q2	19.0	Aug
Israel	+ 4.8	Q2	+ 3.6	Jul	+ 1.6	Aug	– 7.7	Aug	+ 1.3	Q2	28.5	Sep
South Africa	+ 4.5	Q2	+ 3.5	Aug	+ 3.9	Aug	– 2.4	Aug	– 8.6	Q2	17.6	Sep
Czech Republic	+ 5.1	Q2	+ 8.6	Aug	+ 2.2	Sep	+ 1.4	Aug	– 4.1	Q2	29.9	Sep
Hungary	+ 4.1	Q2	+ 6.7	Aug	+ 3.7	Sep	– 3.4	Jul	– 8.6	Q2	18.0	Aug
Poland	+ 2.8	Q2	+ 4.6	Aug	+ 1.6	Aug	– 3.3	Jul	+ 0.3	Jul	39.9	Aug
Russia	+ 6.1	Q2	+ 3.4	Aug	+12.4	Sep	+113.4	Aug	+78.3	Q2	159.6	Sep
Turkey	+ 4.2	Q2	+ 8.3	Aug	+ 8.0	Sep	–40.4	Aug	–20.7	Aug	41.2	Aug
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+ 9.9	Q2	+ 5.5	Aug	+ 4.9	Sep	– 2.3	Jul	– 1.4	Jul	1.8	Jul
Latvia	+11.6	Q2	+ 8.9	Aug	+ 7.2	Sep	– 2.7	Jul	– 1.5	Jul	2.1	Jul
Lithuania	+ 8.0	Q2	na		+ 2.6	Sep	– 3.1	Jul	– 1.4	Jul	3.4	Jul
Slovakia	+ 5.1	Q2	+ 4.3	Aug	+ 2.2	Sep	– 2.0	Jul	– 2.4	Jun	15.3	Jul
Slovenia	+ 5.2	Q2	+ 1.4	Aug	+ 3.2	Sep	– 1.3	Jul	nil	Jul	8.1	Jun
Pakistan	+ 8.4	2005†	+13.6	Apr	+ 8.4	Aug	– 7.3	Aug	– 1.5	Q2	10.6	Jun
Saudi Arabia	+ 6.5	2005	na		+ 0.3	Jul	+84.9	2004	+51.5	2004	24.8	Aug

*Excluding gold, except Singapore; IMF definition. †Year ending June.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Oct 13th 2005
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Oct 12th		Dec 31st 2004	
	Oct 12th	year ago	Oct 12th	% a year		one week	in local currency	in $ terms
China	8.09	8.28	14.2	1.95	1,220.8	+0.6	– 8.2	– 6.1
Hong Kong	7.76	7.79	13.6	4.42	14,575.0	–3.9	+ 2.4	+ 2.6
India	44.8	45.8	78.4	5.47	8,540.6**	–2.1	+ 29.3	+ 25.6
Indonesia	10,165	9,140	17,805	12.74	1,103.0	–0.1	+ 10.3	+ 0.7
Malaysia	3.77	3.80	6.61	2.91	928.5	+0.1	+ 2.3	+ 3.1
Philippines	55.8	56.4	97.8	7.88	1,958.3	+0.9	+ 7.4	+ 8.0
Singapore	1.69	1.69	2.96	2.37	2,320.5	–0.2	+ 12.3	+ 8.4
South Korea	1,043	1,149	1,826	3.97	1,217.1	–0.8	+ 35.8	+ 34.9
Taiwan	33.4	33.9	58.5	1.55	5,987.4	–2.4	– 2.5	– 7.4
Thailand	41.0	41.4	71.7	4.15	709.2	–1.1	+ 6.2	+ 0.7
Argentina	2.96	2.98	5.19	4.93	1,604.6	–2.6	+ 16.7	+ 17.0
Brazil	2.23	2.83	3.91	19.45	30,614.0**	+1.5	+ 16.9	+ 39.0
Chile	529	603	927	3.96	10,013.9	–1.0	+ 11.7	+ 17.3
Colombia	2,300	2,562	4,028	6.52	6,782.3	–2.6	+ 56.1	+ 59.6
Mexico	10.9	11.3	19.1	8.94	15,103.2	–3.9	+ 16.9	+ 19.7
Peru	3.39	3.31	5.94	2.95	5,056.9	–0.9	+ 36.3	+ 31.9
Venezuela	2,659§	2,486§	4,657	11.49	19,512.5**	–4.7	– 34.9	– 36.8
Egypt	5.76	6.24	10.09	9.32	49,254.8	+3.2	+100.3	+111.2
Israel	4.64	4.47	8.13	4.07	764.2**	+0.6	+ 18.7	+ 10.4
South Africa	6.56	6.62	11.5	7.10	16,332.5	–1.6	+ 29.0	+ 10.8
Czech Republic	24.6	25.7	43.1	1.90	1,411.3	–4.1	+ 36.8	+ 24.1
Hungary	208	202	365	6.01	22,214.8	–4.3	+ 50.7	+ 30.7
Poland	3.23	3.50	5.65	4.54	32,891.8	–2.4	+ 23.5	+ 14.7
Russia	28.6	29.1	50.0	13.00	966.9‡	–4.2	+ 62.3	+ 57.4
Turkey	1.36	1.49	2.38	15.60	33,118.4	–4.8	+ 32.6	+ 31.8
EM (MSCI)*	1.00	1.00	1.75	na	636.8	–2.5	+ 17.4	+ 17.4
EMBI+†	1.00	1.00	1.75	na	351.9	–1.7	+ 6.8	+ 6.8

*Emerging Mkts. †J.P. Morgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Floating exchange rate. **Oct 11th.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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